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14 The Treuhandanstalt: Privatization by State and Market

Wendy Carlin and Colin Mayer

To date, most of Eastern Europe has pursued privatization through markets: auctions, vouchers, mutual funds, and stock market flotations have all been widely advocated. The state has been viewed as an impediment whose involvement in the enterprise sector needs to be terminated at the earliest opportunity. There is one exception. Despite having an unusual abundance of managerial and financial resources, responsibility for restructuring East German enterprises has fallen on a state agency, the Treuhandanstalt (THA). This paper is an exploration of the way in which the THA has undertaken its function and of the lessons, if any, that it provides for the rest of Eastern Europe. We are not concerned here with the process of German unification and the course of events that rendered the vast majority of East German industry unprofitable (see, for example, Akerlof et al. 1991; Sinn and Sinn 1991; Dornbusch and Wolf, chap. 5 in vol. 1). This paper focuses on how the THA has engaged in restructuring and privatization in a situation in which the majority of tradable-sector jobs were under immediate threat.

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Section 14.1 describes the principles and methods by which the THA operates. These include extensive restructuring of enterprises prior to privatization, identification and evaluation of potential purchasers, and imposition and monitoring of conditions relating to sales of enterprises.

Section 14.2 describes the THA in operation. It discusses a case of a restructuring and privatization of a heavy industry *Kombinat* in Leipzig. This provides valuable insight into the significance that the THA attaches to considerations other than sale price, the procedure by which the THA evaluates social as well as private benefits, asset disposals, the formation of management and supervisory boards, and the interaction of the THA with Western firms, banks, and regional governments.

Section 14.3 turns to the central question: Why is the involvement of the state not just an unwarranted interference with market processes? The THA offers some clues. It is clear that considerations other than sale price have been crucial in privatizations: foremost among these are employment and regional/industrial policy. The attainment of these objectives has required nonmarket forms of restructuring. This can be seen by contrasting the operation of the THA with three market alternatives: simple auctions of enterprises, auctions with employment subsidies, and conditional auctions with employment and investment requirements attached. The interaction between employment and investment requirements in attaining the objectives of privatization is an important limitation on market processes.

Market transactions are limited in other ways. Allocating control of an enterprise through sales involves competition for ownership by purchasers of shares. This ensures appropriate patterns of ownership and control only where all potential purchasers have access to capital on equal terms. This is clearly not the case in Eastern Europe: domestic credit is severely constrained in relation to that available to overseas purchasers. It is therefore far from evident that market sales allocate ownership and control appropriately.

In addition to the attainment of the social objectives of employment and regional policy, there is a second basic issue: How can distortions created by credit constraints be avoided? East Germany offers only limited guidance on this. Even in the country that is commonly associated with the most industrially oriented banking system in the world, there is little evidence of financial support for East German enterprises. To date, the distinctive feature of East Germany is that enterprise control has not been retained within East Germany; privatizations have virtually exclusively involved transfers of ownership and control to Western enterprises. However, there is evidence that this may be on the point of changing, and East Germany provides important insights into how the process of privatization can be associated with debt financing and hence the retention of local ownership and control.

To many, the experience of East Germany will appear to be of only limited relevance to other countries. The abundance of managerial expertise and financial resources in West Germany sets East Germany apart from the other

East European countries. On the other side of the coin, monetary union created problems that were specific to Germany. East Germany is therefore regarded as a case of its own.

Section 14.4 argues that this judgment is too quick. The resources and problems may be different, but the objectives and requirements for their successful attainment are similar. East Germany illustrates the pitfalls of restructuring and privatization and the process by which they can be contained. This involves a gradual transfer of control from central agency to private enterprise. The paper concludes that retention of domestic control does not require an initial abundance of domestic managerial resources.

14.1 The Treuhand's Method of Privatization

14.1.1 Supervisory Boards

The creation of the Treuhandanstalt predates economic union between East and West Germany. Ownership of all state-owned enterprises (SOEs) was transferred to the trust agency in March 1990. SOEs with more than 2,000 employees were converted into AGs (German public stock corporations) and smaller SOEs into limited-liability companies (GmbHs). When the West Germans took over and reorganized the Treuhand, they were the owners of some 8,000 enterprises with a total employment of about 4 million (Kühl 1991, 682). They assigned smaller enterprises (with fewer than 1,500 employees) to regional subsidiaries of the THA and the larger enterprises to the industry-based divisions of the THA in Berlin. We do not discuss the privatization of very small businesses such as shops, kiosks, and pharmacies.

The Treuhand is a public agency with a supervisory board (the *Verwaltungsrat*) in which important interest groups in Germany are represented: the federal government (economics and finance ministries), state (Länder) governments, the Bundesbank, the commercial banks, major West German firms, the trade unions, and, to signify the importance of non-Germans in privatizations, two European businessmen.

One of the THA's first tasks was to ensure that all its enterprises with more than 500 employees had a supervisory board (*Aufsichtsrat*). These boards have a similar composition to the *Verwaltungsrat:* there are "shareholder" representatives from local government, banks, and other companies. "Employee" representation is established by law at one-third of the supervisory board for firms with fewer than 1,500 employees and half for larger firms. Chairpersons of supervisory boards are drawn from among the shareholders' representatives on the board and have casting votes in the event of a tie between shareholder and employee representatives.

Table 14.1 records the source of supervisory board members and chairpersons in East German firms. A large majority of both representatives and chairpersons come from Western (usually West German) companies. West German

Table 14.1 **The Origin of "Shareholder" Representatives and Chairpersons of Supervisory Boards of East German Enterprises**

	Supervisory Board Members (%)	Supervisory Board Chairpersons (%)
Other companies (mostly West German)	60–70	80
Banks (West German)	20–25	20
Local government	10–15	—

Source: Data supplied by the THA, September 1991.

banks account for one-fifth of both seats on boards and chairpersons. Local governments have some representation on boards but do not hold any chairperson positions.

Supervisory boards oversee the formulation and implementation of restructuring plans. They discuss proposals with senior management of East German enterprises, suggest modifications, and monitor their implementation. They are a source of management expertise providing East German managers with advice and assistance. They have the power to dismiss management where necessary and are instrumental in bringing in new management. Supervisory boards assist East German firms in making contacts with Western (usually West German) firms and help create markets for East German products.

Table 14.2 reports that most new managers come on consultancies and short-term contracts from West German firms. Between one-fifth and one-quarter are active managers of West German firms, and between one-twentieth and one-tenth are retired managers.

14.1.2 Valuation and Evaluation of Enterprises

All THA enterprises were required to submit an opening balance sheet in deutsche marks and a business plan to the Treuhand. The original intention of the THA had been to establish independently audited balance sheets for its enterprises and to offer enterprises for sale, providing potential buyers with this balance sheet and the business plan. A key problem emerged quickly and led to a change in strategy: in the absence of a market for real estate in East Germany, the book value of enterprise property was too low, with the result that property developers tried to purchase enterprises purely for the expected capital gain on land.

The valuation problem revealed a deeper concern in the Treuhand with "unconditional" sales of firms: the THA was interested not simply in securing the highest price for the enterprise but in transferring ownership to a purchaser who would continue to operate the business.

The THA carried out an evaluation of the potential viability of each of its enterprises in a market economy. It set up a team of eighty top West German managers (*Leitungsausschuß*) to evaluate opening balance sheets and restruc-

Table 14.2 **New Managing Directors of Treuhand Firms from West Germany**

Consultants and managers on short-term contracts (%)	70
Active managers (%)	20–25
Retired managers (%)	5–10

Source: Data supplied by the THA, September 1991.

Note: Of 8,786 THA firms surveyed in 1991, there were 23,673 Eastern and 2,631 Western managers in the "most senior" management positions (reported by Mayhew and Seabright 1992, 118).

turing plans of each of its enterprises and to indicate how profitability could be achieved over the next two to three years. Restructuring plans included required reductions in employment and changes in products and processes.

The Treuhand team made a judgment as to whether an enterprise could be restructured successfully and assigned the enterprise to one of six categories (Carlin and Mayer 1992, 329). Enterprises assigned to categories 5 and 6 were judged not to be capable of successful restructuring and were destined for closure.

Balance sheets had to be adjusted to ensure that the 70 percent of enterprises categorized as "potentially viable" had a chance of survival. In particular, liabilities incurred by the enterprises to the state bank under the central planning system had to be written off. The method adopted by the THA was to compare projected turnover, assets, and liabilities of East German enterprises with equivalent firms in West Germany. The capital structure of these West German firms was used as a yardstick for the THA enterprises. Old debts were written down so as to create a "confirmed" balance sheet (the so-called *festgestellte Bilanz*), which gave the THA firm a fair chance of survival for two to three years (for a worked example, see *Informationen,* no. 5:8–9 [THA 1991a]). THA officials estimate that about three-quarters of the DM 106 billion in old debts will be written off through this procedure.

14.1.3 The Terms of Sales: Price, Employment, and Investment Guarantees

Contracts for sales include guarantees by purchasers of minimum levels of employment and investment in an enterprise as well as a sale price. Penalty clauses are written into contracts that specify the THA's share of capital gains in enterprises sold within five years of their privatization and payments due to the THA if the investment and employment guarantees are not fulfilled.

Negotiations over sales prices involve discussions about employment and investment guarantees; discounts on sales prices are made on a per job and per deutsche mark of investment guaranteed basis. From discussions with Treuhand officials, it appears that the reduction in the sales price per job guaranteed has increased over time from DM 12,000–15,000 to up to DM 50,000 in recent deals. This is consistent with data showing sales revenue received by the THA per job guaranteed declining from DM 23,100 to DM 16,600 from the first to the second half of 1991. Over the same period, investment guarantees per job guaranteed have risen from DM 75,100 to DM 115,000. This is consistent with a trend toward jobs being made more secure (data supplied by THA officials, 1991).

The imposition of employment targets reflects the obligation placed on the THA by the government to take account of the social costs of unemployment. For example, the THA takes DM 300,000 per job as the opportunity cost of permanent unemployment for large chemical enterprises, and it incorporates this into comparisons of the costs and value of liquidations and privatizations (McKinsey & Co. 1991, 2–7).

The THA official in charge of the sale of a particular enterprise takes the restructuring plan of the firm drawn up by the incumbent management and the supervisory board and forms a view (often with the assistance of outside management consultants) of the maximum number of jobs that can be saved. Buyers for the enterprise are sought by the management and the THA. Employment targets are paramount, and enterprises can be sold for an effective negative price. This is achieved by combining a sale price of DM 1.00 with investment grants to purchasers. (The number of DM 1.00 sales has declined since balance sheets have been adjusted and debt written off.) In exchange, the purchaser makes investment and employment guarantees.

The submission to the management board of the THA (the *Vorstandsvorlage*) sets out the terms of the proposed disposal of the enterprise and the business plan of the purchaser.

14.1.4 Restructuring Prior to Privatization

East German enterprises faced intense competition in their domestic market immediately after German economic and monetary union on 1 July 1990. On the basis of an analysis of input-output data, Akerlof et al. (1991) estimated the expense in ostmark of major East German enterprises (the *Kombinate*) earning a deutsche mark in Western markets. They found that less than 10 percent of employment in these enterprises was viable in covering even short-run variable costs.

This cost problem was exacerbated by the collapse of the CMEA (Council for Mutual Economic Assistance) and the Soviet Union as a purchaser. It is estimated that between 900,000 and 1 million industrial jobs were dependent on sales to former command economies (FCEs), with more than half going to the Soviet Union (*DIW Wochenbericht,* no. 12 [1991]:127). Fourteen percent of East German industrial output was sold to FCEs. The much faster than expected loss of markets to the East underlined the importance of restructuring.

The huge East German *Kombinate* were typically organized along product lines with plants scattered across East Germany. Incumbent managers saw the supply of output to the Soviet Union as providing the rationale for keeping *Kombinate* (comprising up to twenty enterprises) together as a unit. Synergies within *Kombinate* were regarded by managers as the source of their enterprise's competitiveness in supplying the Soviet market.

To avoid widescale collapse through bankruptcy, the THA initially provided 100 percent guarantees for liquidity credits to all enterprises. Guaranteed loans were granted across the board without any evaluation of the risk of default. The amount of loans guaranteed was expected to cover 40 percent of forecast losses in the enterprise sector. Enterprise managers perceived a relatively hard budget constraint and responded by cutting employment. Table 14.3 records reductions in employment in THA-owned enterprises to the end of 1991. Total employment in THA-owned firms has declined by 65 percent, of which 23 percent is attributed to employment guarantees in firms that have been sold (i.e., jobs that have been saved) and 42 percent to job shedding and closures. Since the completion of the evaluation of potential viability at the end of 1991, the THA has stopped all guaranteed loans to enterprises in categories 5 and 6; enterprises in these categories are now required to secure bank loans without THA guarantees.

The loss of Soviet markets encouraged the Treuhand to break up *Kombinate* into legally separate enterprises; the view was that buyers for the huge industrial holding companies could not be found. By the autumn of 1991, plans were in place for reducing the number of holding companies by one-third and the number of subsidiaries of holding companies by two-thirds (THA 1991c).

Despite its motto—"Privatization as the best form of restructuring"–the THA has been actively involved in restructuring. It has become increasingly evident that large industrial conglomerates must be broken up if viable firms are to emerge. Management and, in some cases, supervisory boards have frequently obstructed the breaking up of the old structures. As owner of the enterprises, the THA can dismiss the supervisory board. In addition, a new law was introduced in 1991 to enable the THA to separate subsidiaries of holding

Table 14.3 Reduction in Employment in THA-Owned Firms (thousands)

	Employment in THA Firms	Fall in Employment	Of Which, Accounted for by Employment Guarantees in THA Firms Sold	Accounted for by Labor Shedding and Closures[a]
1 July 1990	4,000			
1 January 1991	2,979	1,021	201	820
1 July 1991	2,310	669	338	331
1 January 1992 Forecast	1,404	906	391	515
Total		2,596	930	1,666

Source: Calculated from Kühl (1992) and data supplied by the THA.

[a]This is an approximation obtained by subtracting jobs guaranteed from the total reduction in employment in THA firms. Note that, in some contracts, the number of jobs guaranteed rises over time.

companies from the parent enterprise and to enable subsidiaries to take the initiative for separation from the parent (Heimpold, Kroll, and Wilhelm 1991, 36–40).

The Treuhand had decided on the closure of over 700 enterprises even before the completion of the classification exercise described above. More than four-fifths of closures are being carried out using a form of liquidation that places priority on salvaging viable parts of the enterprise rather than on meeting the claims of creditors (Carlin and Mayer 1992, 329–30). The liquidation team is maximizing the number of jobs saved or created on the sites of enterprises being closed.

14.1.5 The Privatization Record

In the year and a half since the West Germans took control of the THA, they have succeeded in disposing entirely of over one-third of their enterprises (table 14.4). Over one-quarter of these have been closed or wound up. The total number of enterprises that are or were owned by the THA has grown since Union by virtue of the splitting up of firms discussed above. Nearly one-quarter of THA firms have been sold to the private sector—nearly one-quarter of which have been sold to East Germans as MBOs (management buyouts). As table 14.4 indicates, the role of foreign buyers has been very limited.

Table 14.4 Sales and Disposals of Enterprises by the Treuhandenstalt

Status of Treuhand Firms as of the End of 1991	Number	% of Total THA Enterprises
Firms disposed of in their entirety[a]	4,594	41.9
Sold to the private sector	2,700	24.6
Of which, sold as MBOs[b]	646	5.9
Of which, sold to foreigners	248	2.3
Reprivatized (returned to previous owners)	527	4.8
Transferred to local authorities	250	2.3
Being closed	865	7.9
Other (wound up through closure, merger, or splitting up)	252	2.3
Enterprises still to be disposed of[c]	6,376	58.1
Majority owned by private sector	615	5.6
Majority owned by THA	5,706	52.0
Total enterprises that are or were owned by the THA[d]	10,970	100.0

Source: Calculated from data supplied by the THA.
[a]Includes enterprises for which transactions have been decided but which may be incomplete.
[b]A further 248 parts of enterprises have been sold as MBOs.
[c]Note that the Treuhand announces as its "headline" figure for privatizations the total of all firms for which it has sold at least a part. By the end of 1991, this number was 5,210.
[d]This number frequently changes, as enterprises are split up and reorganized.

Table 14.5 indicates that the distribution of privatizations by size of enterprise has been very even. As would be expected, MBOs are concentrated in smaller enterprises.

14.2 From *Kombinat* to Private Firm: The Case of Baukema Kombinat

The active involvement of the THA in privatization is illustrated by the case of a former *Kombinat*. This case is used to highlight the creation and activities of the supervisory board; the role of management, supervisory board, and the THA in developing a restructuring plan and identifying and evaluating potential buyers; the splitting up of large enterprises by the THA; the social cost/benefit analysis conducted by the THA and the negotiation of sale price, employment, and investment guarantees; and the behavior of incumbent management under THA ownership.

14.2.1 Background

The Baukema Kombinat was created only in 1987, in what turned out to be the last wave of industrial reorganization in East Germany. It was formed from two distinct groups of enterprises: first, the original Baukema Kombinat, which was a Leipzig-based holding company with its origins in construction machinery, and, second, the Gisag Kombinat, which at the time was an East Germany-wide foundry enterprise with 33,000 employees and its headquarters on the outskirts of Leipzig. Baukema Kombinat took over the core of Gisag (employment of 6,000), located in the Leipzig area.

An early decision of the Treuhand supported by the Baukema board was to separate out the foundries from the rest of Baukema's activities. The grouping together of foundries with construction equipment had no industrial logic, and the organizational structure of Gisag and Baukema had remained fairly separate. In the case study, attention is focused on the foundry side of the business, that is, on Gisag.

Table 14.5 The Size Distribution of Privatizations and MBOs (data as of the end of October 1991)

Employees per Enterprise	% of Enterprises That Have Been Privatized	MBOs by Size of Firm %
<100	11.0	74.1
101–500	14.9	20.9
501–1,000	15.9	.7
>1,000	13.0	0
Unknown	21.1	4.4

Source: Carlin and Mayer (1992, table 5, 332).

14.2.2 The Future of the Foundry Industry and of Gisag

The formal separation of the foundries, centered around the large Gisag AG enterprise, from Baukema AG and their direct attachment to the THA occurred in September 1991—six months after active THA engagement with Baukema began. As soon as Gisag became an AG in May 1990 (before Union), the management sought the advice of the West German foundry association and of the Dresdner Bank (Gisag's *Hausbank*) regarding suitable candidates for the supervisory board. The president of the West German Foundry Association, Eberhard Möllmann, accepted the chairman's position on the supervisory board.

From the outset, the restructuring of Gisag was viewed within the context of the future of the entire foundry industry in East Germany. The starting point for the East German foundry industry was the requirement that it compete with West German suppliers. The structural change undergone by the West German industry since the 1950s was taken as indicative of the required changes in East Germany and in Gisag itself. Fundamental change was required in the scale and composition of foundry output and in the size of enterprises. For example, in a speech at Gisag, Möllman pointed out that the number of foundry firms in West Germany had fallen by 60 percent between 1960 and 1990, with no increase in the average size of the remaining plants. Three-quarters of all West German foundries have fewer than 200 employees. In terms of Gisag, for example, the extrusion foundry had sufficient capacity to supply the entire German market. In 1991, 300,000 tons of output were produced by the East German industry using only 25 percent of available capacity. In Möllmann's view, output from East German foundries could rise to 400,000 tons by the end of the decade.

One of the Gisag foundries cast the components for the tracks of all Warsaw Pact tanks. This order was canceled, and the steel foundry employing 800 workers was closed down completely in the first quarter of 1991. Orders to the other foundries had collapsed with the drop in manufacturing output in East Germany. For example, one of the foundries made crankshafts for Trabants. Production of these cars ceased in May 1991. The finance director stressed the problems with securing orders in current conditions in which the future of the enterprise was uncertain. Customers felt that they had no security of supply.

14.2.3 Management under THA Ownership

Management remained unchanged from pre-Union days, with the exception of the appointment of a personnel manager (from West Germany). From May 1990, the managers spent a considerable amount of time undergoing training. The finance director spent time in Hanover with Salzgitter AG and in Augsburg with Preussag shadowing managers. He learned profit and loss accounting, how to calculate costs and utilize investment planning techniques. The only notable change in the internal organization of the management of Gisag was the increased relative dominance of the finance side as compared with the traditional emphasis on technical/production management.

14.2.4 The Strategy to Sell Gisag

The board of Gisag decided to appoint an expert on the casting industry in Europe (an American, found through the West German casting federation) to assist with finding buyers for Gisag or parts of it. Originally, the managers had taken the view that Gisag should be kept together and should offer the full product palette (steel, iron, shell mold, etc.). At the end of 1990, the philosophy changed as the size of the problem became more evident. Gisag management came round to the idea that the only way of saving any of the foundry business was to split it up. This was partly influenced by the U.S. industry expert and by the supervisory board chairman, Möllmann.

The Treuhand official assigned to the Baukema/Gisag case was a highly experienced West German manager who had been brought in to the Treuhand through the German chancellor's initiative. He engaged a management consultancy to carry out an assessment of Baukema and Gisag. The THA encouraged the use by Gisag AG of the industry expert in particular to try to persuade companies with foundries in West Germany to move with their markets to the East. This reflected recognition of the central problem facing Gisag: how to find a market for its products.

14.2.5 Restructuring and Privatization

By September 1991, two alternative strategies for the Gisag enterprise had been identified by the Treuhand. The choice was to break up the enterprise and sell off the foundries individually or to close the enterprise. The THA made calculations of the cost to them of each of these proposals.

Option 1: Closure. It would cost DM 180 million to close Gisag AG down and sell the assets at liquidation value. No permanent jobs would be saved. The costs of closure include only the direct costs to the enterprise—for example, the *Sozialplan* (cost of redundancies = DM 2,000–5,000 per employee)—and not the costs to the economy as a whole (e.g., unemployment benefits).

Option 2: Privatization. It would cost DM 208 million to privatize the foundries successfully. Successful privatization in this case entails two foundry firms in West Germany (operating in inner-city sites in Frankfurt and Ingolstadt) relocating to the main Gisag site in Leipzig and bringing their orders with them. A Swedish firm is interested in buying the most modern of the foundries (which was built before reunification to supply Volkswagen's engine plant). Another could be sold to a consortium of distributors (from Italy, France, and the United Kingdom) that wanted to establish some production capability. Although the most modern foundry is expected to attract a positive price, the price will be low reflecting the excess capacity in the European foundry business. The other foundries could not be sold at a positive price, and this resulted in the negative price for disposing of the foundry business as a whole. The Treuhand would pay grants to the purchasers of foundries, including reimbursement for their anticipated losses, amounting to DM 37 million. The foundries would be sold for DM 1.00.

Under option 2, purchasers would make investment guarantees of DM 77 million. They would guarantee 980 jobs (out of a current 3,600) as against none under option 1. Thus, 980 jobs would be saved at an additional cost of DM 28 million (i.e., a cost per job of DM 28,000).

The management board of the THA had to decide if this was worthwhile. If the THA were simply a private holding company, then it would adopt option 1 without question. One of the relevant considerations was the external effect of the existence of a foundry industry in Leipzig under option 2. Part of the additional costs required to make privatization possible (i.e., of the cost of option 2) is the outlay required to prepare the site for the operation of the privatized foundries. With one exception, the existing foundries will be demolished and new facilities installed. The buyers get the site for nothing, and their start-up losses are covered. The companies will invest DM 77 million themselves in new facilities. A large part of the investment guaranteed by one of the purchasers would take the form of orders for an independent THA company that makes foundry plants.

In view of the positive external effects of retaining the foundry business and the social costs of increased unemployment, the THA asked the city of Leipzig and the *Land* of Sachsen to contribute to the cost of implementing option 2. A contribution of DM 30 million was sought. To date, DM 10 million has been committed by Leipzig.

The THA adopted option 2 in November 1991. This empties Gisag AG of content—it is simply a shell owning ancillary property, such as nineteen blocks of flats, a hotel, etc. It will be put into liquidation and the assets sold. Additional buyers are being sought for the remaining bits and pieces. Small MBOs on the main Gisag site have been encouraged. To September 1991, five small MBOs had occurred, resulting in employment of 250. A railway siding and line linking the outer Leipzig site to the Leipzig main railway station was sold for DM 100,000; a West German partner was involved in this MBO.

Key features of the sales contract between the THA and one of the purchasers of a Gisag foundry are shown in table 14.6. Of note is the inclusion in the contract of detail concerning the purchaser's existing business and the future business at Gisag.

15.2.6 The Treuhand's Role in the Restructuring

The role of the Treuhandanstalt in restructuring the former *Kombinat* can be summarized as follows:

- Spinning off the foundries from Baukema AG (this has involved the Treuhand taking over the losses of the foundries directly and undertaking closer monitoring of Gisag);

Table 14.6 Elements of the Sales Contract for a Gisag Foundry

The purchaser operates a foundry in *x* [in West Germany] with approximately 600 employees and has particular knowledge and experience and an important market share in the casting industry.

The purchaser will continue to operate the foundry [at Gisag] . . . and on the same location after the renewal of the area . . . by the seller [THA] will erect a *y*-foundry with modern competitive technology with a capacity of *z* tons and providing a level of 200 rising to 600 permanent full-time jobs, investing a total of DM 40 million.

If the purchaser sells or transfers the land . . . to a third party before the 31 December 1993, then the purchaser must transfer 80 percent of the proceeds to the THA.

The purchaser will continue the business of *y*-casting and expand it in the following way: the purchaser will by the end of 1993 have invested at least DM 20 million in the *y*-foundry, in particular for the procurement and installation of a new large molding plant, and by the end of 1995 a further DM 20 million.

If by the end of 1993 there are not binding orders for the investment of DM 20 million, then the purchaser must pay the THA the difference between the value of such orders and the DM 20 million. . . . The purchaser will provide quarterly reports to the THA on the actual and planned investment.

The purchaser is obliged to provide at least the following number of full-time jobs and to report employment at the end of each quarter. . . . If this obligation is not met, then for each missing job the purchaser must pay the THA for the period of the missing employment per month a penalty of DM 2,000 . . . [up to] DM 2,500. . . .

The penalties do not apply only when the nonemployment of workers comes about through force majeure or through the failure of the THA to provide the essential services.

Source: THA.

- Restructuring Gisag AG by separating out the foundry activities from the other Gisag enterprises (e.g., foundry plant construction);
- Evaluating the costs of closure (option 1);
- In conjunction with management, identifying buyers for the individual foundries (option 2);
- Securing the retention of foundries in Leipzig (this involved separate negotiation with potential purchasers for each foundry);
- Seeking to persuade *Bund, Länder,* and local government to contribute to the costs of pursuing option 2 (the higher-cost option to the Treuhand) on the grounds that its social cost is lower once account is taken of the employment, regional, and industrial implications;
- Winding up the remaining activities of Gisag through a liquidation team.

14.3 State versus Market Systems of Restructuring

The distinguishing characteristic of East German privatizations is the close involvement of a state agency, the Treuhandanstalt, in the restructuring of firms prior to privatization. The German government has not sought to privatize enterprises at the earliest opportunity; instead, considerable emphasis has been placed on two considerations, employment and industrial/regional policy. The THA's guidelines for the privatization of enterprises state that account should be taken of the following: the continued operation and modernization of the business by the purchaser; securing employment; effects on the viability of suppliers from East Germany; contribution to the economic strength of the area around the enterprise; the future contribution to tax income (THA 1991b). The Gisag case illustrates these concerns quite clearly. By delegating control to an agency whose objectives include broader social criteria, the German government was redressing the balance between its interests as owner and its function as guardian of the East German productive sector. Inevitably, conflicts arise between these objectives, and these have been reflected in disputes between the Finance Ministry and the Economics Ministry over policies pursued by the Treuhandanstalt.

An impediment to privatization comes from emphasizing these broader considerations. Were it the case that the THA merely wished to maximize the proceeds from sales or dispose of assets at the earliest opportunity, then it would be difficult to dispute the proposition that an auction of assets would have been a more appropriate mechanism. However, once other considerations become relevant, the design of an auction becomes more complex. Essentially, an auction represents the interests of only the owners of the enterprise (namely the state), not other stakeholders, such as employees and local communities.

One possibility would have been to have invited tenders to bid for enterprises that had employment subsidies attached; such a procedure could have internalized the social value attributed to increased employment. There are two problems associated with employment subsidies. First, the development of industries in particular areas of East Germany is part of a broader industrial policy. There are externalities across firms in their decisions to locate in particular areas: the willingness of one firm to locate is dependent on the decision of others. The internalization of such networking considerations is not easily achieved through either simultaneous or sequential auctions.

Second, employment decisions can be reversed at low cost to employers but potentially at high cost to employees, local communities, and dependent suppliers and purchasers. Thus, although the state could have provided employment subsidies in the form of an ongoing subsidy that changed in line with employment rather than in the form of a discount on the initial purchase price, the costs to other stakeholders could not have been avoided. The Treuhandanstalt has clearly placed considerable emphasis on the quality of jobs, that is, on how secure they are as well as on how many are saved. Penalties could have been attached to shedding labor, but that would have introduced a third consideration into the auction process alongside price and employment subsidy, namely, the creditworthiness of purchasers. Penalties are of little value if employers go into liquidation. Problems of enforcing contracts are likely to be particularly acute for foreign firms whose assets cannot be seized in the event of default on employment obligations.

As a consequence, the THA has sought combinations of employment *and* investment guarantees from prospective purchasers. On the assumption that there are sunk costs associated with capital expenditures and that there is complementarity between investment and employment, investment guarantees introduce an element of irreversibility into employment decisions that employment subsidies on their own cannot achieve. For example, suppose that an investment subsidy of DM 50 million is paid on an expenditure of DM 100 million and that this is just sufficient to ensure a zero net present value on a private valuation. If, at the end of the five-year contractual period, the present value of the asset is DM 25 million, then the investment will be retained, provided that the realizable value of the asset has fallen more than 75 percent below its purchase price.

One example of where the THA has applied this principle is in relation to microelectronics. The THA has had interest in one particular site from a Far Eastern manufacturer that wishes to build a new microelectronics factory with a capital expenditure of DM 300 million and another buyer who is interested in the site as a depot for storage and the loading and unloading of lorries. The THA is inclined toward the first offer because of the greater commitment that the capital expenditure demonstrates. Likewise, bidders are more likely to be successful where they promise to build new factories rather than renovate old ones because of the greater sunk investments associated with the former.

As in the case of employment subsidies with penalties for labor shedding, sales that are conditional on investment requirements involve credit evaluations of the ability of the purchaser to sustain the operation of its investments. The THA therefore looks carefully at the nature of potential purchasers. One example of where the credit evaluation failed was in the microelectronics industry. A West German firm established a GmbH with DM 100,000 to purchase a THA firm and then threatened to put the GmbH into bankruptcy if the contract was not altered to its advantage.

Several of the functions of the Treuhandanstalt can be seen as a response to the above problems with auctions: the evaluation of the viability of different parts of an enterprise; the assessment of the social as well as private value of the maintenance of operations; the stipulation of investment and employment requirements; and the careful analysis of prospective purchasers (table 14.7).

However, there is one aspect of the operation of the Treuhandanstalt that the above does not capture, and that is the emphasis that has been placed on the creation of supervisory boards. To date, their function has essentially been limited to managing the transition process. Members of the supervisory board monitor and evaluate the incumbent management; they advise in the formulation of restructuring plans; they assist East German firms in establishing contacts with Western firms and finding outlets for their products in the West; and they help the THA find prospective purchasers. Important though these

Table 14.7 Market Alternatives to the Treuhandanstalt

Market Process	Problems
Simple auction	Does not allow for social/private divergence in values of employment and industrial/regional policy
Auction with employment subsidy	Reversibility of employment decisions. Credit evaluations required to enforce penalties. Does not internalize cross-firm externalities arising from regional and industrial effects
Auction with investment and employment requirements	Credit evaluation of prospective purchasers is necessary

functions are, to date they have been transitional in nature. Once a company has been successfully sold in whole or in part, then the supervisory board and the holding company are frequently disbanded, as the Gisag case illustrates.

Over the last year, a more permanent role for the creation of supervisory boards has emerged. To date, banks have provided little finance to East German enterprises that has not been guaranteed by the Treuhandanstalt. There has been some risky lending associated with small-scale MBOs. Recently, West German banks have shown increased interest in providing both risky debt and some equity capital (see Carlin and Mayer 1992, 340–41). The significance of this is that, once East German companies are able to raise finance without selling all their equity to Western firms, then the creation of enterprises that are owned and controlled by East Germans becomes feasible. Of course, this has already occurred with small-scale privatizations; however, large-scale privatizations have to date usually involved wholesale purchases by Western firms.

Credit constraints are the main reason why sales to Western firms are almost unavoidable in the initial stages of privatization. However, it would be wrong to conclude that the *availability* of finance is the constraint on the development of East German enterprises. The reason why interest is now being shown by West German banks in lending to East German firms is that viable companies are beginning to emerge. The monitoring and control functions of supervisory boards have been central to this development. Through their position on supervisory boards, banks accumulate valuable information on the quality of prospective borrowers. Banks are therefore just at the point of being confident that they can identify sound investments. When this happens, the role of the supervisory board will extend crucially beyond mere assistance with the transition process to the creation of self-sufficient enterprises. An early statement of the guidelines for the privatization policy of the THA states that, in assessing offers, the continuation of the business if possible as an independent enterprise unit should be taken into account (THA 1990, 3). As the next section explains, this self-sufficiency may be of even greater significance to the rest of Eastern Europe than it is to East Germany.

14.4 The Relevance of the Treuhandanstalt Experience to the Rest of Eastern Europe

There are several important respects in which the privatization problem in East Germany differs from that in the rest of Eastern Europe. On the negative side from the German perspective, economic and monetary union has made much of the East German enterprise sector uncompetitive. For many firms, the costs of restructuring to achieve commercial viability in the unified German economy exceed the expected present value of the restructured firm (to a private owner). On the positive side, East Germany has access to all the resources associated with one of the most highly developed economies in the world. These resources include transfers from the federal government,[1] institutional structures, legal systems, accounting and bankruptcy laws, training and apprenticeship schemes, management, and finance. The East German experience may therefore be felt to be of only limited significance for the rest of Eastern Europe.

While not denying the existence of these differences, many of the problems that the THA has been attempting to tackle are probably of even greater significance in the rest of Eastern Europe than they are in Germany. The two that will be discussed here are industrial policy and ownership and control of enterprises. Much of the activity of the Treuhand can be viewed as an attempt to reconcile the interests of individual firms with those of regions and industries as a whole. In particular, the emphasis on investment and employment conditionality was viewed as a response to problems of reversibility of corporate policies that act against the local or industrial interest. That concern becomes more relevant when one is talking about whole nations rather than regions of an economy.

While investment requirements can be used as a method of committing purchasers to take account of broader interests in relation to assets under negotiation, it cannot bind purchasers to the longer-term interests of localities in relation to investments that have not yet even been contemplated. In other words, there is no system of investment and employment requirements that can effectively ensure congruence of interest of firms and nations in long-term corporate strategy. That is why nationality of ownership matters. What the German system of corporate ownership and control largely through the supervisory board has been very successful in doing is internalizing the externalities that exist across firms within a nation.

The implication of this is that, in the long term, an important function of the Treuhandanstalt has been to integrate East Germany into the German pattern of ownership and control. Control is gradually being devolved from the Treuhandanstalt via supervisory boards to German industry and banks. In contrast,

1. For an assessment of the cost of the Treuhand, see *DIW Wochenbericht*, no. 7 (1992): 63–68; and Carlin and Mayer (1992).

auctions merely transfer ownership to those who have the best access to financial resources. In the case of Eastern Europe, that means Western firms: credit constraints on East European investors prevent control from being retained domestically. The solution is not simply to provide finance; what is required is the development of self-sufficient organizations. Once credible enterprises have been created, then finance will flow naturally. What is lacking are the mechanisms by which autonomous enterprises can be created.

One of the lessons to be learned from the Treuhandanstalt experience is that the establishment of control structures does not require preexisting managerial resources. As the previous sections have mentioned, East Germany has often simply purchased managerial and supervisory services from mainly West German firms. They could equally well have come from any country. The social obligation felt by West German managers and banks may have allowed East German firms to purchase their services at below-market rates, but that is all. The purchase of foreign services does not involve the loss of ownership and control because there is no investment; finance is only raised once the necessary management skills have been acquired, and then funds can be purchased in the form of debt rather than equity with no effect on ownership and control.

The central objection to market sales therefore is that they fail to create appropriate control structures before finance is raised. The lesson that the Treuhandanstalt can provide is how these control structures can be established without allowing the abuses of state control to persist.

14.5 Conclusions

To date, the Treuhand has secured employment guarantees for 1 million of the initial 4 million employees in THA firms. The criteria by which this performance should be judged are unclear, and it is not the purpose of this paper to evaluate the success of the Treuhand. Instead, the paper has the more limited aim of examining how the THA has sought to sell firms subject to employment, regional, and industrial policy constraints imposed by the government. Auctions, be they simple auctions, auctions with employment subsidies, or auctions with investment and employment conditions attached, cannot readily attain those objectives. Instead, the functions of the Treuhandanstalt can be understood as a response to the problems associated with auctions.

Six central functions of the Treuhand have been identified. It establishes the social value of firms; it disposes of uneconomic activities; it creates supervisory boards; it finds prospective buyers; it evaluates them; and it imposes investment and employment conditions.

These functions lend the Treuhandanstalt an important role in managing the transition process. In the last part of the paper, a longer-term effect of the East German approach was suggested. The creation of supervisory boards and the training of East German managers are gradually permitting the evolution of self-sufficient enterprises that can raise debt finance externally while retaining control over operations. In the longer term, the Treuhandanstalt is therefore devolving control not only to Western enterprises but also to East German firms themselves.

The transition issues and the reconciliation of social objectives of employment and regional policy are as relevant to Eastern Europe as they are to East Germany. The longer-term issue of ownership and control is probably of greater relevance to the rest of Eastern Europe: in the German case, control remains within Germany; in other countries, control may not be retained domestically. The approach of the Treuhandanstalt suggests that effective corporate control structures can be created without adequate managerial resources being available domestically.

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Comment Wilhelm Nölling

The very interesting paper presented by Wendy Carlin and Colin Mayer has two objectives. On the basis of a case study, they paint a clear picture of the complex tasks facing the Treuhandanstalt, which started with over 4 million employees and was thus the largest holding ever to exist. Carlin and Mayer then discuss the important question of the significance of this "German model" for the other countries of Eastern Europe.

The key role of the Treuhandanstalt was and is to cushion the destructive effects of the 300 percent or more appreciation and total exposure to worldwide competition. Its activities are greatly influenced by the following factors: (*a*) the millions of property restitution claims lodged by West German citizens; (*b*) the strong investment incentives that are being financed directly out of public funds from West Germany and the EC; (*c*) the terrible environmental pollution caused by East German industry; (*d*) the fact that wages increased so rapidly; (*e*) the continued movement of skilled labor to the West; and (*f*) the lack of accountable ownership, which means that there is no effective control of the use of public funds.

At present, the functions of the Treuhandanstalt are as follows: monitoring whether the conditions imposed on enterprises that have already been privatized (e.g., employment and investment obligations) have been fulfilled; closing enterprises that cannot be restructured; and privatizing as well as maintaining and restructuring, the remaining portfolio of Treuhandanstalt enterprises. A new approach, however, is being contemplated, consisting of three additional methods: (1) allowing bids for whole sectors, such as furniture; (2) involving investment firms, banks, and insurance companies (privatization would then rest with them); (3) founding so-called *Managementgesellschaften,* in which the THA would have only a minority interest (it would be their job to privatize or to consolidate certain parts of the Treuhand portfolio).

Carlin and Mayer mentioned three alternatives to THA policy. These are straightforward auctions, auctions with the provision of employment subsidies, and auctions with provisions for investment and employment guarantees. Finally, they argue that current THA practice is superior to these alternatives.

Auction and participation models have so far not been put into practice, first, because these models were proposed too late in the day and, second, because there were hardly any East German enterprises that offered credible profitability prospects. In addition, the participation model has intrinsic technical difficulties such as time-consuming valuation procedures, denomination of shares, the question of to whom to distribute shares (the issue of social justice), and the guaranteeing of dividends. There is a real danger that such securities would prove worthless and that the whole idea of participation would be regarded as fraudulent.

Guided by experience, theoretical considerations, and an awareness of the vast scope and time scale required in order to approach privatization, the Treuhandanstalt adopted the only rational and economically feasible approach left open. Nonetheless, the task of adjusting policies in the second half of 1991 proved quite difficult. (1) It came as a surprise to many of us when the Treuhandanstalt conceded that it no longer aims to privatize all enterprises in full but is willing to retain minority ownership. In a large number of cases, it has indeed retained a minority stake—something that it had previously refused to do. (2) The THA greatly intensified its efforts to sell to foreign investors and regionalized its operations. (3) Reluctantly, the Treuhandanstalt agreed to participate in special job-creation schemes and training organizations created within the enterprises it administers. Carlin and Mayer fail to examine this aspect, even though it has major implications for the labor market as well as for overall policy (i.e., with regard to the postponement of closures).

In their paper, Carlin and Mayer focus primarily on the role of the Treuhandanstalt in reconstruction. This could lead to the false impression that the Treuhandanstalt generally accords greater priority to reconstruction than to privatization. The Unification Agreement commissions the Treuhandanstalt to "restructure along competitive lines and privatize the former state-owned enterprises." This, however, does not imply any preordained sequence on the part of the government. The Treuhandanstalt has consistently given priority to privatization. It has not tired of emphasizing this fact and has acted accordingly.

If the Treuhandanstalt were to devote major efforts to restructuring, it could easily become a lasting repository for inefficient enterprises—and a bottomless pit for state subsidies. Even under the present policy, the Treuhandanstalt has no choice but to incur gigantic debts that will prevent the stabilization of government finances for years to come.

In view of the large number of enterprises still awaiting privatization in East Germany, there is no alternative but to privatize as much as possible as quickly as possible. A factor that is often overlooked is that the Treuhandanstalt is not in a position to evaluate, monitor, and revise vast numbers of business development plans.

Is "retention of domestic control" an important criterion? In my view, this approach has numerous pitfalls: (i) Enterprises that can be rescued (including those currently making losses) should be transferred immediately to private ownership. Investors whose capital is at risk will take a more realistic view of the necessary restructuring tasks. Investors who reach the wrong conclusions lose *their own money.* The deferment of privatization merely places an added burden on state finances and slows down the restructuring process. (ii) In view of the four decades during which East Germany had no real experience of private ownership of the means of production, there are only three economically viable options for achieving effective local ownership and control: management buyouts; the subsequent sale of residual stakes held by the Treuhandanstalt to the local population; and the restitution of business enterprises to their former owners. (iii) The emergence of large numbers of new small- and medium-sized companies—which could gradually develop into larger units—will help strengthen the local industrial base in the former East Germany.

What are the prospects? (1) As referred to earlier, privatization has proceeded at a fairly rapid pace in certain branches. (2) An increasing number of companies whose products are no longer in demand in East Germany and/or whose markets disappeared with the collapse of the CMEA (Council for Mutual Economic Assistance) are being closed down. (3) Some 5,700 companies are still waiting for action to be taken and are uncertain about whether they face closure. This year, the Treuhandanstalt intends to keep up the rapid pace of privatization achieved in 1991. However, this will prove an even more difficult task as it is reasonable to assume that the companies with the best business prospects have already been privatized. (4) The Treuhandanstalt will continue to hold companies that are in the red within certain branches or regions, either because there is reason to be optimistic about the prospects of reorganization or because current employment or regional policies weigh against closure. In such cases, huge subsidies are required in order to fund technological modernization and/or update training and management as well as to reorganize auditing and to cover losses.

On the basis of these perspectives, it appears that, on the one hand, the tasks of the Treuhandanstalt have become more difficult and complex while, on the other, its work in particular regions or branches could soon be completed—or indeed has already been completed.

Privatization in Eastern Europe and the Lessons of Privatization in East Germany

Privatization does not seem to have made major progress in Eastern Europe. In these countries, we are still witnessing the very earliest stages of privatization. By contrast with East Germany, the economies of the East European countries are not in such a desolate condition or state of collapse because they are not subject to the fatal overnight exposure to worldwide competition. This leads me to conclude that the governments in these countries have more time to enact privatization policies than was available in East Germany. However, the uniqueness of the East German economic reforms lies in the existence of a common language, a common heritage, and the maintenance of many family ties as well as the massive transfer of management skills in the private and public sectors. These are all important advantages that do not pertain elsewhere.

What recommendations can be made on the basis of the German experience? (1) The motto must be, Privatize at virtually any cost. In other words, privatize as much as possible and as quickly as possible. With regard to enterprises that are not yet privatized and that are deemed to have potential, the same policy should be pursued as in East Germany. (2) As in East Germany, the necessary conditions for privatization must be created and made viable in the truest sense. Market-oriented structures must be developed—in particular, clear legislation on property rights and the creation of free-market controls and institutions as well as the removal of investment and wage structure disincentives. Large state-owned enterprises must be divided up and reorganized. (3) As far as lessons for East Europe's privatization are concerned, I would like to emphasize the following. We are all well aware that these countries need wider access to Western markets as well as massive debt relief. Unless these absolutely necessary conditions are fulfilled, it is difficult to conceive that new, stable, market-oriented, capitalist economies will become established in our lifetime.

Discussion Summary

Colin Mayer agreed with Wilhelm Nölling's suggestion that companies should be moved out of Treuhand control as fast as possible. Mayer emphasized that the Treuhand has pursued this goal while simultaneously trying to minimize the associated social cost of the economic restructuring.

Jan Winiecki criticized the recommendations for the rest of Eastern Europe that the authors had drawn on the basis of the Treuhand experience. He said that the Treuhand's supervisory boards had been so successful because they were populated with West German managers. Such highly skilled supervisory boards could not be replicated in countries like Poland. Winiecki concluded by proposing several lessons that the authors had not noted. He said that the Treuhand had demonstrated the advantage of splitting companies and financially restructuring them before privatization.

Andrew Berg and *Stanley Fischer* also suggested that many of the Treuhand's most successful features would be difficult to replicate in the rest of Eastern Europe. Berg emphasized that the Treuhand has the benefit of having relatively easy access to West German financial capital. Fischer stressed the Treuhand's access to West German financial and managerial expertise.

In response to the warnings about the difficulty of replicating the Treuhand's success in other East European countries, Mayer said that these countries could hire the necessary trained personnel from the West. Moreover, he noted, this hiring would be limited to the extent that such personnel would be needed only for some of the positions on supervisory boards, not for day-to-day management of the companies in question. He emphasized that only 10 percent of the managers of East German firms have been brought in from West Germany and that, to date, almost all the MBOs (management buyouts) have been implemented by East German managers.

András Simon noted that the principles of the Hungarian State Property Agency are similar to those of the Treuhand. In particular, both bodies have been given the tasks of opening up balance sheets, commercializing companies, creating control structures, and setting up viable restructured firms. However, he noted that there are also contrasts between the German and the Hungarian approaches. In Hungary, there is less emphasis on implicit employment subsidies because the relatively low real wage suggests that the unemployment problem will be less severe. In addition, the Hungarians have not implemented a policy of debt cancellations.

Simon identified two fundamental problems in Hungary that suggest that the privatization process in Hungary will evolve more slowly than that in East Germany. First, Hungary faces logistical constraints because it does not have access to resources like those in Germany (e.g., trained personnel and a working body of commercial laws). He estimated that, on their own, these logistical constraints put Hungary two or three years behind East Germany. Second, Hungary lacks a social structure that could support a capitalist economy. Hungary has neither savers nor entrepreneurs. He said that Hungary needs a class of risk takers who are willing to manage firms in which they have a personal stake. He estimated that creating a "capitalist society" will take five to fifteen years.

Jeffrey Sachs suggested that the record of the Treuhand did not bode well for other East European countries like Poland. He noted that East German restructuring has taken place in the best possible circumstances: the German government is relatively strong and immune from local politics, and Germany has a very successful monetary policy with a completely independent central bank. Even with these advantages, Sachs noted, the restructuring of East Germany has been accompanied by substantial rent seeking, exemplified by state subsidies that have been channeled through institutions like the Treuhand to support and validate rapid East-West wage equalization. Sachs noted that this outcome may be satisfactory in Germany, where it is possible each year to transfer 75 percent of East German GNP from West Germany. But this option is not available to other East European countries, which have weak governments that face enormous demands on very limited resources. Sachs concluded that the Treuhand structure did not adequately immunize the state from political pressure.

Rudiger Dornbusch responded to Sachs by noting that the policy of wage equalization was actually a deliberate social strategy and hence did not reflect badly on the restructuring process. *Janet Yellen* offered a different twist on this argument. She suggested that one of the interesting attributes of the Treuhand is that the agency has enabled the German government to mask the scope of the massive transfers that are taking place. Yellen said much of the Treuhand's costs arise off budget, like allowing newly privatized firms to sell off land. She believes that the German public would resist transparent expenditures as large as the hidden costs that the Treuhand is accepting. Dornbusch also suggested an unusual strength of the Treuhand. Because the agency uses a variety of mechanisms, it cannot be accused of choosing exactly the wrong one. He noted that, elsewhere in Eastern Europe, the debate over which mechanism is precisely right has enervated the privatization process.

Philippe Aghion suggested that it may be optimal to have more than one privatization agency. Increasing the number of agencies decreases the likelihood of regulatory capture. However, with too many agencies, economies of scale are lost. Aghion conjectured that there may be an optimal number of agencies that balances these two effects.

Jacek Rostowski said that Mayer's conclusion that the Treuhand has pursued a strategy that minimizes the social cost of restructuring was a "Panglossian ex post rationalization." Rostowski suggested that the Treuhand has been successful because it has taken the easy path of distributing the gains from privatization unevenly.

Mayer concluded the discussion by arguing that pragmatic institutions like the Treuhand may end up performing better than hypothetically optimal institutions devised by economists.

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