

THE COMMUNITY AND GERMAN UNIFICATION
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Introduction

1. At the Strasbourg European Council on 8 and 9 September 1989, the Heads of State or Government reaffirmed their commitment to German unification through free self-determination in a peaceful and democratic process, in full respect of the relevant agreements and treaties and of all the principles defined by the Helsinki Final Act, within a context of dialogue and East-West cooperation.

Elections have now been held. The German people have delivered a clear verdict in favour of unity. The conditions have therefore been met for a dynamic and orderly process of unification to go ahead. This process is compatible with the goals of European integration, as was also emphasized at the Strasbourg European Council. Integrating the German Democratic Republic within the Community will call for solidarity and a balanced approach.

2. The step-by-step integration of more than 16.5 million people into a united Germany and hence into the Community — a *de facto* enlargement — poses a major challenge to the German authorities and the Community.

The unreliability of the economic data and the uncertainty surrounding currency conversion make any comparisons between the two Germanys — whether in terms of GDP, per capita GDP, or balance of trade — difficult and speculative, and any attempt to compare the German Democratic Republic with the other Community countries all the more so. The macro-economic aggregates calculated on these bases have to be treated with great caution to take account of the qualitative aspects (the mediocre state of services and infrastructures, and serious environmental problems) as well as the purely quantitative aspects.

The German Democratic Republic's economy may appear relatively strong in broad terms, with per capita GDP markedly higher than in the other CMEA countries and approaching the Community average. Closer inspection reveals severe structural shortcomings and deficiencies in production plant but also real growth potential that could no doubt be quickly stimulated by the need to catch up and modernize.

Looking at the shortcomings and deficiencies, notable effects include the woeful state of housing and

the roads and the manifest inadequacy of the rail network and communications system. The environmental situation, too, is extremely grave and the effect of this is felt well beyond the German Democratic Republic itself.

As for the potential for lasting growth, the level of both general and technical education among East Germans is good and certain sectors (chemicals, optics, electronics, machine-tools) still retain some industrial and technological advantages. There is also a substantial reservoir of untapped productivity gains in terms of labour, capital and business organization, as well as a strong attraction for foreign capital and direct investment, in particular from the Federal Republic, the other Member States and the EFTA countries.

The Commission considers that the unification of Germany represents not only a challenge but also a major opportunity for the Community as a whole because of the additional investment, growth, trade and contacts it will generate at all levels.

Unification procedure

3. Federal constitutional law offers several avenues towards unification. The choice between the procedure laid down in Article 23 of the Basic Law and that of Article 146 is a matter for the Federal Republic and the German Democratic Republic.

Both procedures allow for prior negotiations between the two Germanys on the conditions for unification and would make it possible to take into account developments as they occur during talks on the external aspects of unification. But it should be stressed that the Article 23 procedure is simpler as far as the Community is concerned.

As stated on several occasions, the integration of the territory of the German Democratic Republic into a unified Germany and hence into the Community constitutes a 'special' case. For this reason Article 237 of the EEC Treaty — which relates to the accession of other States — does not apply.

The integration of the German Democratic Republic into the Community through German unification, therefore, does not amount to accession in formal terms. However, the practical problems involved are on a par with those posed by the most recent enlargements of the Community. Now, as then, integration into the Community will proceed by stages, requiring transitional measures to facilitate the gradual application of the 'acquis communautaire'.

One of the first major differences by comparison with a 'normal' accession is that the initial stage of the German Democratic Republic's integration into the Community will take place within the framework of the German unification process, in other words ahead of formal integration into the Community. A second difference lies in the special nature of the case and the absence of the usual negotiations on the conditions of accession. At Community level the similarities noted above and these special features will have to be taken into account to ensure optimum integration of the German Democratic Republic into the Community from the very outset of the interim phase.

As far as the Commission can tell at the moment, it should be possible to integrate the German Democratic Republic in the Community without the need to amend the Treaties. This, of course, is assuming that the body of new legislation applicable in the territory of the German Democratic Republic is compatible with the Treaties as a whole and in particular with those provisions that are directly applicable.

Integration scenario

4. The Commission sees the integration of the German Democratic Republic into a unified Germany, and hence into the Community, taking place by stages:

- (i) The first will be the interim adjustment stage, beginning with the introduction of inter-German monetary union, accompanied by a number of social and economic reforms (Währungsunion, Wirtschafts- und Sozialgemeinschaft).
- (ii) The second, transitional stage will begin with the formal unification of the two Germanys.
- (iii) The full application of the 'acquis communautaire' will not take place until the final stage.

During the interim adjustment stage, the German Democratic Republic will gradually bring in the legislation necessary for step-by-step integration into the Federal and Community system. Consequently, the integration of the German Democratic Republic into the Community will partly take place ahead of formal unification of the two Germanys.

The start of the transitional stage will coincide with the formal unification of the two German States. Community legislation, both primary and secondary, will then automatically apply in the territory of the German Democratic Republic except where the Council specifically decides otherwise (temporary exceptions) on a proposal from the Commission.

Decisions to allow these exceptions will be taken by the competent institutions, sector by sector, on the basis of the relevant Treaty articles. The European Parliament will be involved in the Community's decision-making process under either the consultation or the cooperation procedure. After taking the initiative of setting up an *ad hoc* committee, Parliament called for this in the resolution it adopted.

Problems arising during the interim adjustment stage

5. This stage comprises:

- (i) the introduction of inter-German monetary union;
- (ii) the parallel introduction of the economic and social reforms essential for the progressive introduction of a social market economy in the German Democratic Republic;
- (iii) the progressive integration of the German Democratic Republic into the economic system of the Federal Republic and gradual adjustment of the German Democratic Republic's legislation to bring it into line with Federal and Community law.

A large part of the German Democratic Republic's integration into the Community, then, will take place during this stage, and this will affect the working of the Community and will substantially influence the transitional arrangements applicable once formal unification has taken place.

Care will therefore already have to be taken at this stage to ensure that the process of German unification is compatible with Community law, by facilitat-

ing the German Democratic Republic's gradual integration into the Community and preparing the transitional arrangements in good time. Provisions to this effect should be included, as necessary, in any treaty between the Federal Republic and the German Democratic Republic covering this initial stage.

6. The introduction of inter-German monetary union — and in particular the question of what conversion rates will apply — is essentially a political and economic choice which rests with the two Germans. Nevertheless this choice will involve both macroeconomic and monetary consequences for the Community as a whole. The gradual transformation of the East German economy to the social market model will go hand in hand with large-scale industrial restructuring, which will involve substantial aid from the public purse. The Commission will have to be able to assess such aid in the light of the Community rules on competition. This implies that the Commission will have to be informed in advance in order to ensure that all aids granted are compatible with the Community's objectives and do not discriminate between Community firms and distort competition.

The same attention should be given during the interim period to arrangements between enterprises, State monopolies and public procurement procedures. Lastly, the Commission feels that VAT will have to be introduced in the territory of the German Democratic Republic during this stage.

7. The introduction of the Deutschmark in the German Democratic Republic and the transfer of monetary sovereignty to the Bundesbank constitute the basic elements of German monetary union. A crucial point will be the conversion rate(s) of East German marks into Deutschmarks. The choice of the rate(s) must hold the balance between the need to avoid creating excessive purchasing power, weakening the competitiveness of East German enterprises and causing unemployment as a result, and the need to take account of the German Democratic Republic population's expectations that wages and pensions will catch up with West German standards.

Decisive and immediate economic reforms will have to take place in the German Democratic Republic. To overcome the adjustment problems, investment on a massive scale and additional social transfers are required. Opening up the goods and services, labour and capital markets, together with considerable private investment (from the Federal Republic, other Member States and the rest of the world) and public transfers will build a base for a catching-up process

which could be fairly rapid. But this adjustment period must be able to rely on a labour market that works, an employment, training and conversion policy and the introduction of a social policy for the unemployed.

Exports to the German Democratic Republic could provide a strong boost for demand in the Federal Republic of Germany and the Community, which could translate into a higher growth rate in the medium term.

As far as the Commission can see at present, the most likely prospect is that of a significant positive impact on growth in the Federal Republic and the Community in general. The Federal Republic could enjoy a one percentage point higher growth rate in the next couple of years. This would in turn stimulate Community growth on average by an additional 0.5 percentage points.

To limit the risk of inflationary pressures in the Federal Republic and to help stimulate growth throughout the Community, it will be important for all the Member States to have the same ease of access to the market in the German Democratic Republic to enable them to participate in the restructuring process.

It is likewise important that the Government of the Federal Republic inform and consult the Community about all the steps it takes in the context of German monetary union. The further adjustment of the policy mix within the Community must be coordinated with the competent Community institutions and in the framework of the process of multilateral surveillance at the first stage of economic and monetary union.

8. Parallel to German monetary union, some decisive and immediate reforms towards a social market economy will be introduced in the German Democratic Republic. They will include:

- (i) a comprehensive reform of the price system, which is distorted by subsidies and does not reflect the relative scarcities of goods;
- (ii) a reform of the money and credit system;
- (iii) a reform of the tax and social security system in the direction of the Federal Republic's system;
- (iv) the establishment of an economic and legal framework allowing free enterprise, private property and privatization of public enterprises.

The Commission considers these reforms to be totally in line with preconditions for the German Demo-

cratic Republic's integration into the Community order.

9. The interim period should be used to the utmost to prepare for the application of the basic Treaty provisions guaranteeing free movement of goods and services via the principle of mutual recognition and of secondary legislation on harmonization in the areas of public health and technical safety. During the interim period, the Protocol on German internal trade and the existing controls will continue to apply.

The current volume of German internal trade is not very large: somewhat less than ECU 3 500 million in both directions. Trade with the other Member States amounts to around ECU 1 400 million. Re-export of East German goods from the Federal Republic is negligible. It seems probable that initially, during the interim phase, the trade flow from the Federal Republic to the German Democratic Republic will increase more rapidly than in the opposite direction. The Commission considers that the use of all the instruments available under the Protocol on German internal trade should be sufficient to avoid any distortions of trade, including agricultural trade, during the interim phase. It will make sure that this is the case throughout that phase.

Likewise, in respect of Member States' exports to the German Democratic Republic, equality of access will need to be ensured.

10. From the outset of the interim period, the restructuring of the East German economy will require the input of capital from private and public sources. To begin with, there is the possibility of help through the various instruments available under the scheme for coordinating international economic and financial assistance, in particular through the European Bank for Reconstruction and Development (EBRD).

The German Democratic Republic would also be eligible for aid under the Tempus programme and for assistance from the future European Training Foundation.

The Commission takes the view that the German Democratic Republic should be given access to Community loan facilities (EIB, Euratom, ECSC) from the outset.

Whether, during the interim period, there should be a special Community aid programme (as for Portugal) along the lines suggested by Parliament is a question which the Commission intends to put to the European Council.

11. To sum up, the Commission wishes to stress the need for the full involvement of the Community from the outset in this phase of German unification. Because of the expected impact on Community life, there will have to be a move from information and consultation to real concerted action. This will require an active Commission presence on the inter-German scene and appropriate procedures to ensure maximum transparency as the interim adjustment stage progresses, with due regard for the need for continuous dialogue with the European Parliament and the Council.

Involving Community bodies in this stage will of course mean that there must be contacts between the Commission and the authorities in the German Democratic Republic.

Problems arising during the transitional stage

12. The problems of adaptation to a market economy and of integration into the Community are under active examination by the two Germanys and the Commission as well. They concern both the external commitments of the German Democratic Republic and the application of the internal policies of the Community.

On the external side there is the question of the unified Germany taking over German Democratic Republic commitments. The application in the unified Germany of the Community's external policy and commitments will take place from the date of unification, subject to any transitional measures of a technical kind.

An important principle of the application of the internal policies of the Community — in particular the internal market, structural policies, environment and transport — in the unified Germany from the date of unification should be that this should take place with as few exceptions and transitional arrangements as possible. Until 1 January 1993 controls could, if necessary, be operated within the unified Germany. From that date only end-use control will be possible.

13. The question of external agreements falls into two categories: on the one hand, the application by the unified Germany of agreements already con-

cluded by the German Democratic Republic and, on the other hand, the application of the Community's external agreements in the territory of what is now the German Democratic Republic. The German Democratic Republic has a large number of international agreements which fall mainly into three types: cooperation agreements, framework agreements normally of five-year duration, and annual commercial arrangements — and reflect very closely the present pattern of the German Democratic Republic's trade.

Sixty-five per cent of the German Democratic Republic's current trade is with CMEA countries (of which 40 % is with the Soviet Union alone and 25 % with other CMEA countries), 20 % with OECD countries (including about 8 % intra-German trade) and 5 % with developing countries. The Commission will study these agreements in consultation with the Federal Republic and the German Democratic Republic in order to establish how far they are consistent with Community rules and practice or whether they may require some transitional or other exceptions.

It is important also to recognize that continuation of traditional trade flows has a role to play in maintaining good political and commercial relations with other East European countries. In many cases also, it will be in the interest of the unified Germany that production which is geared to export to some East European countries should continue. The current pattern of trade between the German Democratic Republic and the Soviet Union, in particular, is based mainly on imports of energy and raw materials from the Soviet Union and the export of manufactured goods directed especially to the needs of the Soviet market.

The Commission has also examined the question of the application of the Community's existing international commitments in the whole territory of a unified Germany. Technically, the changes necessary in order to ensure the full respect of the regime at the external frontiers and when goods have passed into free circulation are complex and need close examination. Obviously, once unification is effected the Community, as a legal personality within international organizations, will cover the whole territory of a unified Germany.

14. On the internal side the questions which require the most careful attention are:

- (i) the best means of integrating the German Democratic Republic into the Community's internal market;
- (ii) respect for competition policy;

(iii) the application of common policies, notably those in agriculture and fisheries, to the current territory of the German Democratic Republic after unification;

(iv) the application of the structural policies of the Community, notably in the absence of a fully reliable statistical basis for their application and in the light of the very different economic structure of the German Democratic Republic;

(v) the application of other policies — notably those in the environment and transport sectors, where the needs of the German Democratic Republic are evident;

(vi) the financial consequences of unification for the Community.

15. As far as the internal market is concerned, it is not excluded that from the date of unification, on a temporary basis, some differential treatment might be required for goods and services from the current German Democratic Republic territory in respect of technical regulations or other harmonized provisions.

The Commission does not foresee any major difficulty as far as the free movement of persons, services and capital is concerned. From the date of unification at the latest, German Democratic Republic territory will be part of the customs union, which implies integral application of CCT and commercial policy arrangements except for the necessary transitional measures which may be adopted to take account of the external arrangements of the German Democratic Republic.

The Commission considers, however, that it would be highly desirable if the number of transitional arrangements and exceptions in relation to the internal market after 1 January 1993 should be limited as far as possible. From that date the internal frontiers in the Community will be removed and the form of control will have to be adapted.

Linked with the progressive application of the internal market to the current territory of the German Democratic Republic will be strict attention to the avoidance of distortions of competition. It is probable that there will be a very high level of investment in the current territory of the German Democratic Republic in coming years. It will be necessary to ensure that it does not give rise to serious distortions of competition in goods and services.

The authorities of the Federal Republic of Germany have agreed to inform the Commission of all aid measures designed to rebuild the German Demo-

cratic Republic's economy. The Commission will examine the likely effect of such measures on intra-Community trade in order to prevent any distortions of competition and to ensure non-discriminatory access for all Community firms irrespective of their place of establishment.

The new context of a unified Germany will also require a re-examination by the Commission of certain existing aid schemes in the Federal Republic (Zonenrandgebiet, West Berlin).

The same attention should be given to the application of competition rules applying to agreements between firms. It may be necessary to apply these rules in a sensitive and flexible way to take account of new market realities. Such agreements should not distort competition or affect trade between Member States.

16. When new members have joined the Community in the past, the question of the gradual application of the price system of the common agricultural policy has given rise to detailed and specific exceptions. The pattern of agriculture in the German Democratic Republic differs very considerably from that in the Federal Republic of Germany. Its agriculture is dominated by agriculture cooperatives (LPG) or State farms (VEG), which cover almost 95 % of the cultivated land. The average size of farms is very large — over 4 500 hectares on average for arable farms — and thus represents in general a form of paid employment rather than of family farms.

Notwithstanding satisfactory technical performance, overall productivity in the German Democratic Republic's agriculture is below West European standards, mainly owing to its organization and excess labour force.

The trend of produce prices in the German Democratic Republic will depend largely on how its agricultural system is phased into a market economy as from the entry into force of Inter-German monetary union.

The Commission is of the opinion that the introduction of Community agricultural prices and support systems, at least by 1 January 1993, should not be excluded at the level of production.

For certain products there are very substantial consumer subsidies in operation in the German Democratic Republic at the present time, and these must be phased out. The structural changes which may be expected over a period of time in the German Demo-

cratic Republic's agriculture depend on the decisions of those engaged in that production, but the complications, including the question of land ownership, are considerable and may take some time.

The integration of the German Democratic Republic into the fisheries policy will pose some awkward problems. German unification will result in a substantial increase in the capacity of the Community fleet, whereas resources are already very limited. The capacity of the German Democratic Republic's fleet (which is roughly twice the size of that of the Federal Republic) is out of all proportion to the resources to which it can have access.

As regards markets, fundamental adjustments to the production and marketing structures in the German Democratic Republic are clearly essential. The integration of the German Democratic Republic's fleet into the fishing industry's structural arrangements will also require adjustments to the existing set-up.

In terms of internal resources, unification would mean a small increase in the Community fishing zone in the Baltic. Allowing the German Democratic Republic's fleet access to the other zones could jeopardize the balance in fishing capacity currently in use and the existing balance between Member States. This is especially the case with precautionary TACs, which are not shared out between Member States, given the size of the German Democratic Republic's fleet and its tendency to concentrate on certain stocks (blue whiting, horse mackerel, etc.).

On the external front, the Community will have to take over the bilateral agreements concluded by the German Democratic Republic, and this may entail complex negotiations.

17. As from unification, the Community structural policies will apply to German Democratic Republic territory. By that time the massive and urgent task of economic and social restructuring in the German Democratic Republic will be under way.

Reorganization and restructuring will affect all sectors of the economy and imply vast investments in capital and human resources. The financial burden of these investments will necessarily be a shared one. A large part of the investment effort in the productive sector will be undertaken by the private sector. Additional funding will be necessary from public sources, mainly from the Federal authorities.

German Democratic Republic territory will also be entitled to Community assistance in accordance with

the structural Fund regulations. The criteria contained in these regulations pose certain problems of applicability to the German Democratic Republic in addition to the difficulty caused by the absence of reliable statistics. It can, however, be assumed that the territory of the German Democratic Republic is beset by the same type of problems as are encountered by other regions of the Community and that it will therefore be eligible under one or more of the structural policy objectives.

As far as the European Social Fund is concerned, emphasis should be put on those interventions which enable the German Democratic Republic to meet the challenges of the market economy (vocational training and occupational integration).

The total volume of Community aid will depend on the classification of the regions of the German Democratic Republic with reference to the various objectives of the structural policies.

18. Among the other policies, technical adjustments and transitional measures will probably be required in transport policy and the social sphere (health and safety).

In the field of transport it should also be noted that there is a considerable need for infrastructure improvements.

However, the area which calls for the most particular attention — because of the gravity of the situation in the German Democratic Republic and the urgency of the problem — is the environment.

The roots of the problem go back to the effort made by the German Democratic Republic from its very beginnings to achieve maximum economic autarky, which led to the development and retention of very highly polluting and technologically outdated industries, with a heavy toll in terms of their impact on the environment and public health. For example, the German Democratic Republic is one of the last countries still running a major coal-based chemical industry based on massive use of brown coal.

First, a distinction has to be made between plants where pollution is too high for them to be adapted (which will have to be closed down) and those where anti-pollution equipment could be fitted to bring them closer into line with Community levels. For the latter, it is clear that transitional, and in some cases long-term, exemptions from Community standards will be necessary.

Second, the new investment sectors will have to meet Community requirements. Account will have to be taken of the cross-frontier aspects of pollution (e.g. Elbe, Baltic).

Massive economic investment will be required to retrieve the environmental situation. This applies both to the adaptation of existing plant and to the construction of new plant.

The grave environmental situation is a phenomenon common to all the countries of Central and Eastern Europe. In this connection, the Commission warmly welcomes the special conference due to be held in Dublin in June to consider this whole problem. It believes that the Community, together with the other Western nations, should demonstrate solidarity in the search for solutions.

More generally, a new energy policy for the German Democratic Republic will have to be defined, based on the exploitation of new sources and improved energy efficiency. In this context the problem of nuclear safety will also have to be tackled.

19. As far as the budgetary impact of the German Democratic Republic's integration into the Community is concerned, the Commission's view is that any figures are bound to be guesswork at this stage. The position will, of course, become clearer once the arrangements for inter-German monetary union are settled. But even that will not remove all uncertainty.

On the expenditure side, the cost will largely be determined by the impact of integration on the CAP and the scale of intervention under the structural policies.

On the revenue side, too, much will depend on the transitional arrangements and the macroeconomic impact.

In general terms, we are likely to see vigorous economic growth in the German Democratic Republic, generating higher demand throughout the Community, and an increase in imports from the other Member States. This additional growth will be reflected in additional revenue.

Conclusions

The entry of the German Democratic Republic into the group of democratic countries and the forthcom-

ing unification of the Federal Republic of Germany and the German Democratic Republic are among the most important historical events of postwar Europe and should be given a warm and unreserved welcome. The Community shares the joy of the German people at finding their new place within the unified Germany and within the European Community.

This unification will need to take place under the Community roof. It is therefore imperative that the process of consultation between the two Germanys and the Community should be fully and actively engaged as from the interim phase. On the basis of its extensive contacts so far the Commission is confident that this will be the case.

The Commission considers that German unification offers an opportunity for reinforcing and speeding up European integration.

The Commission sees no reason whatsoever for concluding that the process of German unification and the place of the unified Germany in the European Community will hold back the development of the Community's relations with other countries in Central and Eastern Europe or with the Community's other neighbours or with the Third World. On the contrary, the new developments point to a more prosperous and more open Community, confident in its own democratic values and its increased role in the world.