



DON'T FORGET CAPITALISM'S TRIUMPHS

What we learned from the fall of the Berlin Wall

By Professor Stewart Hamilton - November 2009

IMD

Chemin de Bellerive 23
PO Box 915,
CH-1001 Lausanne
Switzerland

Tel: +41 21 618 01 11

Fax: +41 21 618 07 07

info@imd.ch

<http://www.imd.ch>



Read any newspaper these days and it is clear that the global financial crisis has raised serious questions about both capitalism and globalization. The enormous amount of capital now committed to bailout packages is cause for even greater concern. Before completely rejecting a system, it is worth taking a close look at just how far Europe has come since the fall of the Berlin Wall on Thursday, November 9, 1989.

The wall's collapse and German unification completed a year later at midnight on October 3, 1990 has not only made Germany the largest economy in Europe and the fourth largest in the world. It also cleared the way for the European Union to become a cohesive economic and political entity and for the EU to emerge as the world's largest economy. Along the way, the Berlin Wall's collapse resolved once and for all the advantages of a capitalist market-based economy over one that is centrally planned and ignores market realities. China's emergence as a dynamic economic power after converting itself to a market-based economy only provides further proof.

The economic miracle might not have happened if the West had not stood its ground. At the end of World War II, Stalin predicted that the US would abandon Germany within a year. Europe's economy was in ruins, and the continent seemed headed for the Soviet's vision of a socialist state.

Instead of withdrawing from Germany and ultimately the continent, the US Congress authorized the greatest stimulus package of its time. The Marshall Plan plowed \$12.4 billion (roughly \$111 billion in today's dollars) into rebuilding Europe¹. Most of the money was in the form of loans to buy American products and services. The loans had to be repaid in the country's currency, and the money went into a national fund that was used to further stimulate that country's business development.

Within four years, most of Europe, with the exception of Germany, had returned to its pre-war economic level. Since the US produced most of the goods flowing into Europe, its economy also boomed. Today, the Organization for Economic Cooperation and Development, which ran the Marshall Plan, is known as a club of wealthy nations.

In contrast, the Soviet Union was determined to make certain that Eastern Europe never provided a threat again. Although the Soviets rejected the Marshall Plan, they were able to make up for their losses by stripping equipment and resources from East Germany. As the Soviets gradually took control of one Eastern European country after another, the Cold War was born. The Berlin Wall became its ultimate symbol.

¹ Grogin, Robert C. (2001), *Natural Enemies: The United States and the Soviet Union in the Cold War, 1917-1991*, Lexington Books

In that ideological confrontation, West Germany became a showcase for free-market capitalism. East Germany emerged as a competing showcase for a Soviet-style economy responding to central planning rather than market realities. While East Germany's economy grew faster than other East European economies, it couldn't compete with the west. It did not take long to see which model was more successful.

The Soviets built the Berlin Wall in 1961 when it became clear that without it nearly everyone in East Germany would escape to the west. That began to happen in May 1989, when Hungary decided to drop its portion of the Iron Curtain and opened its borders to East Germans wanting to reach the west. The resulting crisis in East Germany led to democratic elections there in March 1989, and that led to the collapse of the wall shortly afterwards, effectively sounding the death knell of a failed economic concept.

The "German model", extended across a unified Germany, has added fresh ideas to our notions about capitalism. Germany gives an unusually large role to German banks in helping to shape the industrial sector by actively investing in corporations rather than simply collecting savings and making loans. The result is long-term investment in the health of corporations. In industrial relations, Germany encourages unions to work with management councils to arrive at a common understanding of shared goals.

Absorbing East Germany has cost the Federal Republic of Germany an enormous amount in rebuilding the East's infrastructure and in stimulating its economy. Despite the spurt of entrepreneurialism in the east resulting from an influx of capital from the west, there have clearly been adjustment difficulties. But the advantages of having adopted a free enterprise market-based approach are also clear to just about everyone. Attempts to make a centralized planned-economy in the east failed miserably, which is an irrefutable argument in favor of free market capitalism.

It is only necessary to take a brief stroll through Warsaw, Prague or Budapest today to see how the transition to free enterprise has empowered individuals, encouraged entrepreneurialism and brought life to sectors of society that were previously moribund. The same applies when looking at the economic transformation that we have witnessed in China.

There is no doubt that the financial crisis has raised questions and that a new set of internationally agreed standards and parameters are needed. But it is also important not to forget how far we've come and how we got here. This summer, Germany's growth had been projected to contract by -0.6% in 2010². Now it is now projected to expand instead by +0.3%, even in the midst of the global downturn.

² IMF Global Financial Stability Report, September 30, 2009

More important, Germany has emerged as a powerful force for democracy in Europe. The policy planners who gambled on economic expansion and a market-based approach to a pan-European economy back in the 1940s appear to have won their bet.

Rightfully, our current system needs to be dissected so we can avoid such financial crises as the one we are enduring. By the same token, capitalism's critics would be short-sighted to ignore the symbolism of the Berlin Wall's fall and the progress it helped create.

Professor Stewart Hamilton is Professor of Accounting and Finance at IMD. He teaches on the Executive MBA, High Performance Boards, Orchestrating Winning Performance and Strategic Finance open enrollment programs. He also teaches on IMD's Partnership Programs.

RELATED PROGRAMS



EXECUTIVE MBA - <http://www.imd.ch/emba>

Never stop learning

Program Director Philip Rosenzweig

- A rigorous, diverse and global program for experienced executives
- Sharpen your leadership skills, drive your learning into your company and fulfill your potential
- An execution-oriented program that focuses on turning ideas into action
- Thought leadership that you can put to use right away: earn a world-class MBA on the job



HIGH PERFORMANCE BOARDS - <http://www.imd.ch/hpb>

How board directors make a real difference

Program Director Paul Strebel

- Understand your board's power structure and culture
- Deal with the challenges facing your board
- Develop an action plan to ensure that you and the board create value