

*November 11, 2019*

## **Thirty Years Since the Fall of the Berlin Wall: A Retrospective, Part I**

On August 13, 1961, the German Democratic Republic (GDR), otherwise known as East Germany, began construction on a barrier that would slow the emigration of Germans to the Federal Republic of Germany, known as West Germany. Prior to the construction of the wall, it is estimated that 3.5 million East Germans emigrated to West Germany from 1950 until 1961, often by crossing from East Berlin, which was under Soviet Union control, to West Berlin, under Western allied control. After the wall was built until November 9, 1989, it is estimated that 100,000 people tried to circumvent the wall, with approximately 5,000 making it across safely. An [estimated 140 to 200](#) escapees were killed by border guards or by lethal impediments to escape.

By the spring of 1989, the Eastern Bloc was starting to unravel. On July 7, 1989, Soviet President Mikhail Gorbachev implicitly ended the Brezhnev Doctrine, which gave Moscow the power to intervene in any Warsaw Pact nation. [Gorbachev stated that “any interference in domestic affairs and any attempts to restrict the sovereignty of states—friends, allies or any others, is inadmissible.”](#)

Gorbachev was reacting to developments already in place. In 1988, Poland, which

had been moving away from Moscow for some time due to the Solidarity movement, was the first to break with the Eastern Bloc. Hungary moved to a multi-party democracy in the spring of 1989, and on May 2, 1989, it [began to dismantle](#) the 150-mile border fence that separated Hungary from Austria. Over the summer and autumn of 1989, the “crack” in the Iron Curtain led to an outflow of Czechoslovakians and East Germans. Before East German officials could stop their citizens from “traveling” to Hungary, it is estimated that 30k East Germans had fled to the West. By October, demonstrations in the GDR had grown in both number and frequency. According to reports, Erich Honecker, the leader of the GDR, had planned a Tiananmen Square-type massacre of protestors.<sup>1</sup> However, GDR security forces refused to fire on its citizens. Honecker’s last hope was Soviet troops stationed in his country. However, due to Gorbachev’s rejection of the Brezhnev Doctrine, the Soviet forces did not intervene.

On November 1, 1989, the border with Czechoslovakia was opened to the West. East Germans began to travel west via this opening. Protests in the GDR expanded, and, on November 9, the border checkpoints on the East and West German frontier and in Berlin were opened. In effect, the Berlin Wall and the border between East and West Germany were a fiction.

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<sup>1</sup> Fulbrook, Mary. (2002). *History of Germany, 1918-2000: The Divided Nation* (2<sup>nd</sup> ed.). Malden, MA: Fontana Publishers. p. 256.

The breaking of the barrier known as the Berlin Wall was a key event marking the beginning of the end of Soviet communism. By 1991, the U.S.S.R. had unraveled, and several of the numerous republics within the former Soviet Union had become independent states. The Soviet Union no longer existed.

For those of us who spent our lives under the shadow of the Cold War, seeing the Berlin Wall being dismantled was shocking. The world for anyone born after 1947 was one of two competing blocs with fundamentally different systems. The differences between the two blocs were profound and incompatible. With the unwinding of the Soviet Union two years later, anything that resembled traditional Marxism was relegated to outposts like Cuba or North Korea. Mainland China, which to this day describes itself as communist, operates as a capitalist economy.

Considering these amazing events, a number of trends emerged that reflected what leaders, at the time, believed the end of communism meant. After three decades, we now have a better notion of how well these ideas fared and can reflect on the lessons one should take from such important events. In Part I of this report, we will cover two ideas about the post-Cold War era and how well they fared. In Part II, we will cover two more ideas and conclude with market ramifications.

### **Idea #1: The End of History**

Francis Fukuyama wrote an article in *The National Interest* in the summer of 1989 titled, "[The End of History?](#)" The title itself was something of an ironic twist. Marxists, using the dialect system borrowed from Hegel, postulated that history was progressive, moving from thesis to antithesis

to synthesis. Essentially, the old order (thesis) faces a new competitor (antithesis); the two conflict and a new order (synthesis) emerges. The synthesis is expected to contain the best elements of the old and the new. Hegel's view of history is that it is a progression toward some perfect endpoint. For Marx, the endpoint was a classless society where labor would own the means of production.

Fukuyama argued that the end of communism showed there was no alternative to liberal democracy and capitalism for development or governance. Fascism had been vanquished in WWII and communism essentially ended with the fall of the Berlin Wall. The last system left standing was liberal democracy and capitalism.

This thesis did not go unchallenged. Samuel Huntington offered a different forecast, suggesting the end of the Cold War would lead to new problems, namely, a clash of civilizations. In an article in [Foreign Affairs](#), he argued that the Cold War provided a structure that subsumed other conflicts and these underlying fights between cultures would return now that the Cold War had ended. Huntington's vision was widely criticized at the time.

Fukuyama's vision of the post-Cold War world became expressed in policy in what was called the Washington Consensus. This "consensus" was a set of policies that the U.S. indicated was optimal. These included democracy for governance, free trade, open capital markets and multilateral trade agreements, codified in the World Trade Organization, for international economic relations. Following an undefined "rule of law" in international relations was also an element of the consensus. In practice, this meant using a U.N. mandate to legitimize

military intervention or economic sanctions. In domestic policy, deregulation was fostered. Domestic fiscal prudence was part of this policy as was the reliance on monetary policy as the primary tool for economic management.

Over the 30 years since the fall of the Berlin Wall, Fukuyama's projection and the Washington Consensus look ill-conceived. The Afghan and Iraq Wars undermined American claims of rule of law. Although liberal democracy did expand for a while, the 2008 Financial Crisis seriously damaged the confidence in the Washington Consensus "cookbook" of economic management. Since 2008, there has been a clear trend toward populism and authoritarianism that have echoes of fascism. The end of communism didn't lead to liberal internationalism but a surge in parochial nationalism. In short, history did not end. In fact, the whole idea that human history is a progression toward betterment is an Enlightenment concept that is questionable.

A key lesson learned from the "End of History" narrative is that analyzing success is perhaps even more important than scrutinizing failure. It is normal to learn from failure; the pain of being wrong or losing triggers soul searching that aims to improve. Of course, it is possible to learn the wrong lessons from failure as well. Nevertheless, rarely do organizations, sports teams or companies take a critical eye toward success. Often, success is taken for granted, a product of superior skill, knowledge and preparation. I am often surprised at how sportswriters will frame a champion as inevitable. It is rarely the case; often, a champion had a few things go right that could have just as easily gone wrong. That is why it's rare for sports dynasties to occur or for businesses or governments to last forever.

So, why did the West win the Cold War? Clearly, capitalism proved superior to communism. The former merely required humans to behave in their own interest; communism required people to develop virtues rarely seen in nature. George Kennan's "[long telegram](#)" essentially argued that the West simply needed to contain and "wait out" the communist bloc in order to win. Kennan's prescription turned out to be accurate.

However, there were a few actions along the way that helped end the Cold War peacefully that were simply circumstantial. The Saudi decision to recapture its crude oil market share in 1986 led to a sharp drop in oil prices which severely crimped the Soviet economy. Mikael Gorbachev's policies of openness and criticism, and his decision not to use military force to enforce the Brezhnev Doctrine allowed the Cold War to end with a whimper. It should be noted that the Chinese leadership felt they were facing a similar situation at Tiananmen Square in 1989; Deng Xiaoping responded with massive military force and vanquished the protests. The Chinese Communist Party remains in power. It is not out of the question to consider the Warsaw Pact may have survived if Gorbachev had responded with force.

In addition, framing Russia into communism failed to grasp another factor about Russian behavior. Much of the key geographies of Russia sat on the Great Northern European Plain. This plain has few natural barriers to invaders. Therefore, throughout Russian history, rulers have attempted to expand westward to force potential invaders to cover more territory, extend supply lines and hope that winter weakens the invading force. However, Russia has gone through periods where the expense of holding this territory

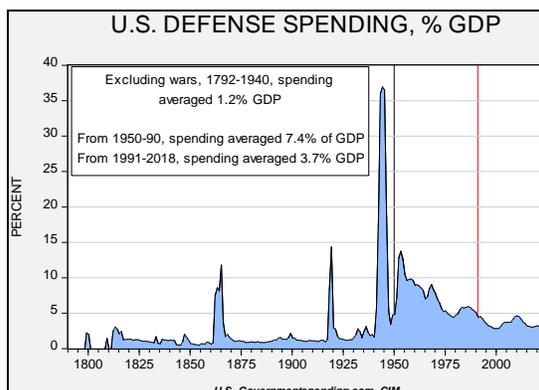
becomes impossible to maintain; the empire collapses onto itself but, over time, it works to reestablish this invasion buffer. In other words, Russian history is a cycle of territorial expansion and contraction. After the fall of the Berlin Wall, Western thinkers seemed to assume that Russia was a fully spent force and doomed to collapse. Instead, it appears the fall of the U.S.S.R. was nothing more than a cyclical collapse which was likely to bring an attempt to re-expand. Most likely, Western thinkers were trapped in a Cold War mindset and failed to see how Russia might recover.

Overall, the policy leaders in the U.S. and the West overestimated the contribution of capitalism and liberal democracy to the fall of the Soviet Union and the unwinding of the Warsaw Pact, while they underestimated the various factors that allowed the Cold War to end peacefully. This overestimation led to a triumphalism that fostered other serious policy mistakes.

### Idea #2: The Peace Dividend

The end of the Cold War convinced U.S. policymakers that the world was a safer place and thus the level of military spending could be reduced.

To frame this issue, we start with a history of U.S. defense spending.



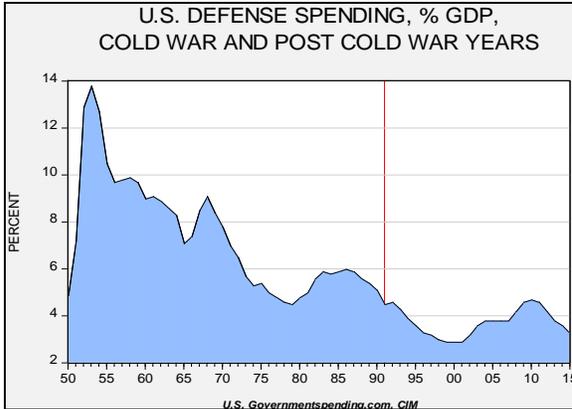
Before the U.S. accepted the hegemonic role in the late 1940s, the U.S. tended to avoid foreign involvement, only becoming active when conditions warranted. The preceding chart measures U.S. defense spending, scaled by GDP. From the inception of the republic until the onset of WWII, U.S. defense spending was closely tied to wars. The Civil War, WWI and WWII are clearly delineated. If we exclude the wars from 1792 to 1940, U.S. defense spending averaged about 1.2% of GDP, a level consistent with a small power. Note that after each war, a measurable demobilization followed. Even after WWII, there was a sharp drop in defense spending. However, as the U.S. accepted the role of global superpower, coupled with spending tied to the Korean War, defense spending remained elevated. From 1950 to 1990, defense spending averaged 7.4% of GDP.

Hegemony was not an American aspiration. The U.S. is a country of immigrants, many of whom come here fleeing conditions in their original nation. Getting involved in the world required these same Americans to deal with issues that they wanted to avoid by coming here in the first place. To overcome this obstacle, President Truman framed stabilizing the world under the rubric of the containment of communism. The needs to demilitarize Europe and the Far East, along with the stabilization of the Middle East, were separate from communist containment but were “sold” as being part of that effort.<sup>2</sup>

As the Cold War continued, Americans were willing to accept the burden of hegemony. But, with the end of the Cold War, there was a call for capturing a “peace dividend.” In other words, with the need for communist

<sup>2</sup> For a deeper examination of this issue, see WGR, [The Mid-Year Geopolitical Outlook](#) (6/25/18). Also, this issue was discussed in our recent podcast series, [The Confluence of Ideas](#).

containment over, Americans should not have to pay as much for defense. U.S. politicians obliged.



This chart shows the same data as the previous chart but focuses on the Cold War and post-Cold War years. We have placed a red line to show the fall of the Berlin Wall. U.S. defense spending was around 4.5% of GDP at that time. It fell to a low of 2.9% by 2001.

Although some cuts in defense spending may have been reasonable, the reductions that were made were arguably excessive. The U.S. still needed to stabilize the three aforementioned areas of world. However, that isn't what Americans were told during the Cold War. In addition, the rise of Islamist terrorism suggested that Samuel Huntington was likely correct—the end of the Cold War would unleash cultural, religious and ethnic conflicts which required higher defense spending. Overall, if there was a peace dividend, it was likely much smaller than the actual reductions that were made.

**Part II**

Next week, we will discuss two more ideas and conclude with market ramifications.

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