Germany: As private equity companies boom, social democrats advise the “locusts”

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Private equity companies are playing an increasingly important role in the global economy, and increasingly, German politicians, including many leading members of Germany’s Social Democratic Party (SPD), function as advisors to these companies.

With the increasing concentration of wealth over the last two decades, private equity firms have developed to procure incredibly profitable investments for those with large fortunes at their disposal. These companies administer the billions of the super-rich, but also act on behalf of pension funds.

These private investments always amount to at least several hundred thousand euros. Since financial advisers recommend placing only small amounts of available capital into these funds—risky businesses can also fail—only multimillionaires can afford to be involved with a private equity company. They are a means for very rich people to rapidly make themselves even richer.

Like the hedge funds derided by Labour Minister and Vice-Chancellor Franz Müntefering (SPD) as “locusts,” the private equity companies scour the globe seeking lucrative investment opportunities. Since the 1970s, they have regarded themselves as an alternative to companies listed on the stock market. In the past, they usually acquired a majority of shares in a company to then have this de-listed from the stock market and broken apart. Portions of the company would be sold off, jobs cut and wages lowered. Usually, the purchase is largely financed through debt capital, with the burden of the repayments falling on the company that has been taken over. Finally, the company is sold off—at a massive mark up—or listed again on the stock market.

Private equity companies have been well established in American and British markets for more than 20 years, but more recently, these financial investors have become increasingly active in Europe and particularly in Germany.

Above all, various laws introduced by the last SPD-Green Party government under Gerhard Schröder (SPD) have contributed to their growth in Germany. For instance, in 2002, capital invested by private equity companies in Germany amounted to €6.9 billion. Two years later, it was already €22.5 billion. The main reason for this rise was the introduction of a law removing taxation from the sale of shareholdings.

Globally, the proportion of private equity companies in corporate buyouts was about 3 percent in 2000. By 2004, this had increased to 14 percent, reaching a volume of $294 billion. In the meantime, at least one fifth of all mergers and acquisitions can be attributed to private equity companies. In view of the worldwide boom in private equity, major banks like the Deutsche Bank, UBS or Credit Suisse, but also private banks such as Sal Oppenheim or Berenberg Bank, have significantly developed their offerings for super-rich private customers.

The activity of private equity funds is expected to exceed all records again this year. “We expect the world-wide volume for such funds will be from 450 to 500 billion US dollars,” according to Private Equity Intelligence. Since private equity companies generally commit only 20 percent of their own capital in any buyout, their investments could leverage corporations worth approximately $2.5 trillion.

This development is an objective process inherent to international capitalism. Globalisation has increasingly uncoupled the creation of surplus value from the production process. The worldwide supremacy of finance capital and the pressure to obtain ever-higher net yields on capital investments is directly bound up with the ever-harsher attacks on wages and social spending. Private equity companies are one of the mechanisms through which social polarisation expands. The inconceivable wealth of a small layer of the super-rich is only the opposite pole to rapidly growing poverty and sinking wages.

The claims by some leaders of Germany’s Left Party and the trade unions that it is possible to put a stop to this process within the framework of capitalism is pure charlatanism. Those who support capitalist property relations cannot also seriously oppose these international private equity funds, even while deriding them as “locusts” or as the representatives of “robber baron capitalism.” This is the reason why, wherever the Left Party exercises political power and where the trade unions negotiate collective agreements, they unreservedly defend the interests of big business and the employers.

The London-based finance company Terra Firma Capital Partners hopes to sell off the motorway services operator Tank & Rest in a lucrative deal. The firm was initially established as a separate public corporation in 1994 out of two state-run enterprises.

In 1998, this was then privatised through a sale to Lufthansa as well as to various private equity companies. The deal took place under the auspices of the then-transport minister, Franz Müntefering (SPD). Seven years later, in the 2005 Bundestag (federal parliament) election campaign, Müntefering introduced the term “locusts” to describe private equity companies and hedge funds.

At the end of 2004, Terra Firma bought up the enormous gas station and restaurant operator. Now it wants to sell the enterprise. In June, the Deutsche Bank bought a 50 percent share in Tank & Rest, for which it is reputed to have paid at least €1.2 billion. This was a massive boost for Terra Firma, which still owns the other 50 percent, since it only paid €1.1 billion in 2004 for the entire company.

The Schröder government specifically encouraged the integration of the political establishment with the activities of these financial speculators. Today, Schröder’s ministers, expert advisors, trusted colleagues and business friends are to be found in the top echelons of the private equity companies. Roland Berger, a close friend of Schröder and an advisor on the Rürup Commission looking into the restructuring of old age pensions, is “German chairman” of the “international advisory board” of the world’s largest private equity company, Blackstone.

One of the markets in which Blackstone is interested is telecommunications. Last spring, Finance Minister Peer Steinbrück (SPD), also well acquainted with Berger, brought in Blackstone as a large shareholder in Deutsche Telekom AG—which is still 30 percent owned by the federal government. It is no coincidence Blackstone is advised by former Telekom boss Ron Summers, who enjoyed good relations with the SPD-Green Party government and was rewarded with a "golden handshake" in 2002 when he left Deutsche Telekom.

One of the largest markets in which numerous investment funds are interested is German housing, where they are reaping huge profits from the privatisation of public dwellings. Besides the German company Annington, the owners of more than 150,000 dwellings in the Ruhr area purchased from EON (which was formed in 2000 through the fusion of two former state-owned corporations), it is the American private equity companies Fortress and Cerberus that are active in the German housing market.

In September 2004, Fortress acquired Gagfah (a non-profit housing corporation) for approximately €3.5 billion. The Gagfah group now possesses more than 170,000 dwellings. In July 2005, Fortress bought Nileg (another public housing corporation) with its 28,500 apartments for rent for €1.5 billion.

A little later, in March 2006, Fortress acquired all the public housing owned by Woba in Dresden, some 47,000 dwellings. One in five Dresden residents, who used to live in a building owned by Woba, now pays rent to this private equity company. The Left Party, which controls the city council, fêted the deal with Fortress as a great success.

Florian Gerster (SPD), who for two years was head of the Federal Labour Agency, is now chairman of Germany's Investment Advisory Board. In 2002, Schröder placed the SPD politician from Rhineland-Palatinate in the Federal Labour Agency. In 2004, he had to vacate his post when he signed contracts worth millions of euros with an advertising agency as well as three further consulting contracts with Roland Berger and IBM—all without any formal tender process. Before he went, he "restructured" the Federal Labour Agency—in other words, destroyed jobs and massively stepped up productivity, as well as supporting drastic cuts in unemployment benefits. Today, Gerster is an advisor for Fortress where he "earns" many times his old salary at the Federal Labour Agency.

However, Gerster is not the only time-served social democrat in the service of Fortress. The head of Fortress subsidiary Gagfah is Burkhard Drescher. As mayor of Oberhausen in the Ruhr, he was regarded for a long time as the SPD's great hope to lead the state legislature in North Rhine Westphalia. In 2004, however, he decided on a career in business and went to work as chairman of the board of real estate company RAG Imobilien. Drescher was in good company at RAG. Werner Müller, a former economics minister under Schröder heads the company, and former economics secretary Alfred Tacke (SPD) leads the RAG subsidiary company Steag. Another advisor to the company is former finance secretary Manfred Overhaus (non-partisan).

Since August of last year, Drescher's main job for the American investors is to dispel tenants' fears regarding rent increases and the sale of their homes to another company. Fortress, according to Drescher, said from the beginning "that it was not in the housing business"—it was inevitable synergies would develop and jobs had to be reduced. The fact is, more than one in five jobs have gone.

But Fortress's hunger for housing is far from being assuaged. In its coalition agreement with the Free Democratic Party (FDP), the North Rhine Westphalia state government of Jürgen Rüttgers (CDU) has agreed to sell off approximately 100,000 dwellings belonging to the LEG State Development Agency. Fortress, which already owns nearly 5,000 LEG dwellings, is ready to clinch the deal.

In May-June of this year, Cerberus (in Greek mythology, the "hellhound" that guards the gates of Hades) bought the Chrysler division of the DaimlerChrysler corporation for €5.5 billion. Its largest real estate purchases include the Wilhelmshaven public housing corporation Jade and its 7,500 dwellings, bought from the Deutsche Bank in 2004. The same year, Cerberus took over the non-profit housing corporation Wohnungsbaugesellschaft Berlin. Here, the Left Party shares responsibility for the sale as coalition partner to the SPD in the Berlin city government.

In November 2005, Cerberus bought up a former trade union-owned housing corporation and its nearly 23,000 homes.

A TV documentary said of this deal: "Most tenants have never experienced rent increases like those introduced recently: up to 20 percent more a month. This is hard to manage for the low-income families living there. These properties were once part of a public housing scheme."

After just 20 months, Cerberus resold the former union-owned housing, with 60 percent going to Deutsche Bank and 40 percent to Italy's Pirelli Real Estate. Cerberus received roughly €1.7 billion, thereby doubling its investment.

At the end of 2005, Cerberus bought up another larger real estate package, again from a trade union-controlled company. Of these 37 properties, 10 are various trade union headquarters buildings in the former East Germany (including in Berlin, Dresden, Leipzig, Zwickau, Bautzen, Magdeburg, Rostock, Jena and Suhl) as well as Verdi's union headquarters in Hanover. Both sides agreed to keep the purchase price secret.

Cerberus is also active in Austria. In December 2006, it bought the BAWAG bank from the Austrian trade union federation ÖGB for approximately €3.2 billion. Following the takeover, current Cerberus boss and former US Finance Minister John Snow will join the bank's supervisory board.

The Cerberus payroll includes many old acquaintances: Wolfgang Bernhard, formerly a DaimlerChrysler and Volkswagen board member, sits alongside former Defence Minister Volker Rühe (CDU), as well as his successor Rudolf Scharping (SPD), who has worked for the company for some time.

Trade unionists and politicians of all stripes stand ready to serve up the "locusts" further public property on a silver tray. As a first step, the German government under Angela Merkel (CDU) is to sweeten the work of the private equity companies—no longer having to pay any taxes on the venture capital they invest.

This would put them on an equal tax footing with unit trust funds, which also pay no taxes. Fund managers would only pay tax on 40 percent of their incomes. This would lead to a tax shortfall of approximately €500 million compared to the plans included in the coalition contract originally agreed by the CDU and SPD.

With this, the private equity industry has achieved at least some of its demands, according to a report in *Financial Times Deutschland*. But the private equity companies are demanding that such tax privileges also be extended to all other aspects of the business of financial investors, not just for venture or risk capital.