The Problem of Adjustment in West Germany's Balance of Payments

I

Whatever the ultimate solution of West Germany's balance of payments problem, the surpluses of recent years have been an interesting test of the process of balance of payments adjustment. The purpose of this paper is to examine the causes of the " favourable " imbalance and the various methods by which it might have been corrected.

The general outlines of the balance of payments are given in Table I. It will be seen that there was a surplus on current account in every quarter but one from the middle of 1951 to the middle of 1957, in only two quarters was there a (very small) deficit on current and capital accounts combined, in every quarter there was a substantial increase in the international reserves of the Central Bank. The " favourable " imbalance shown in Table I has been one of the most striking in recent decades. The persistence and magnitude of the growth of reserves do not come off badly even if compared with the phenomenal growth of American official gold holdings between 1934 and 1939, usually quoted as an exceptional example of the failure of the adjustment process (1).

(1) An important difference between the American and German cases is that American gold holdings grew primarily as a result of an influx of capital from Western Europe, German reserves grew primarily because of a surplus on current account. One would have expected, therefore, that the German imbalance would be corrected more easily than the American in the absence of official intervention. The best analysis of the American case is to be found in " Capital Imports and the American Balance of Payments, 1934-39 " by A. I. BLOOMFIELD. In the five years from December, 1934 to December, 1939, American official gold holdings rose by 9 billion dollars, in the five and a half years from December, 1951, German gold and foreign exchange reserves grew by 4.5 billion dollars.

In the German case there is some evidence that various forces were tending to correct the imbalance. This is brought out in Tables II and III. According to Table II, after two years in which every quarterly surplus on current account was greater than the surplus in the corresponding quarter of the preceding year, the opposite happened in 1954. The new situation lasted until the

Table I

BALANCE OF PAYMENTS OF FEDERAL REPUBLIC
(million D.M.)

Period	Current Account (Surplus + Deficit —)	(of which the trade balance)	Donations & Capital Transfers (Surplus + Deficit —)	Balance on Current & Capital Account (Surplus + Deficit —)	Net Change in Reserves (Decrease + Increase —)	Errors & Omissions
1951 1st Quarter	— 600	— 414	+ 480	— 120	+ 240	— 128
2nd »	+ 550	+ 713	+ 610	+ 1160	— 1100	— 61
3rd »	+ 360	+ 499	+ 410	+ 770	— 890	+ 122
4th »	+ 460	+ 695	+ 130	+ 590	— 270	— 320
1952 1st Quarter	— 10	+ 156	— 40	— 50	— 120	+ 170
2nd »	+ 920	+ 854	+ 20	+ 940	— 1180	+ 238
3rd »	+ 950	+ 852	— 70	+ 880	— 860	— 19
4th »	+ 490	+ 300	— 40	+ 450	— 270	— 177
1953 1st Quarter	+ 570	+ 444	— 120	+ 490	— 630	+ 145
2nd »	+ 1080	+ 974	— 50	+ 1030	— 890	— 133
3rd »	+ 1020	+ 960	— 130	+ 890	— 1040	+ 155
4th »	+ 1470	+ 1274	— 60	+ 1410	— 1030	— 384
1954 1st Quarter	+ 1090	+ 1077	— 70	+ 1020	— 930	— 91
2nd »	+ 850	+ 883	— 380	+ 470	— 560	+ 85
3rd »	+ 1150	+ 1093	— 350	+ 800	— 740	— 63
4th »	+ 880	+ 871	— 40	+ 840	— 500	— 342
1955 1st Quarter	+ 770	+ 800	— 280	+ 490	— 530	+ 39
2nd »	+ 780	+ 775	— 360	+ 420	— 590	+ 167
3rd »	+ 330	+ 552	— 380	+ 50	— 300	+ 347
4th »	+ 1070	+ 1175	— 310	+ 760	— 500	— 264
1956 1st Quarter	+ 958	+ 976	— 381	+ 577	— 686	+ 109
2nd »	+ 1447	+ 1681	— 259	+ 1188	— 1275	+ 87
3rd »	+ 1231	+ 1287	— 285	+ 946	— 1550	+ 604
4th »	+ 1863	+ 1755	— 537	+ 1326	— 1159	— 167
1957 1st Quarter	+ 1582	+ 732	— 1039	+ 543	— 913	+ 370
2nd »	+ 2077	+ 1202	— 1267	+ 810	— 1470	+ 660

fourth quarter of 1955. During 1955, as Table III shows, the rate of growth of imports was so much greater than the rate of growth of exports, that in the third quarter the surplus on current account fell short of the combined deficit on donations and capital transfers.

Table II

INCREASE OR DECREASE OF CURRENT ACCOUNT SURPLUS COMPARED WITH CORRESPONDING QUARTER OF PRECEDING YEAR
(million D.M.)

	1952	1953	1954	1955	1956	1957
1st Quarter	+ 590	+ 550	+ 500	— 300	+ 150	+ 624
2nd »	+ 360	+ 150	— 200	— 80	+ 650	+ 630
3rd »	+ 590	+ 100	+ 100	— 800	+ 840	
4th »	+ 20	+ 1000	— 600	+ 200	+ 690	

This situation was of brief duration. Before the end of 1955 the current account reverted to large quarterly surpluses, which continued throughout 1956, and reached quarterly peaks for the whole six-year period. Exports again expanded much more than imports. The result was another very large increase in the Central Bank's international reserves, which rose by the equivalent of one billion dollars, or by one-third of their level at the end of 1955.

Table III

RATES OF GROWTH OF IMPORTS AND EXPORTS.
% GROWTH OVER PRECEDING YEAR

	Imports		Exports	
	Value	Volume	Value	Volume
1951	29.5	2.0	74.3	43.2
1952	10.0	15.6	16.0	7.9
1953	- 1.2	13.1	9.6	16.8
1954	20.8	25.3	18.9	23.5
1955	26.6	21.4	16.7	15.1
1956	14.3	11.8	20.0	15.7

About three quarters of this increase was due to the receipt of gold and dollars from the E.P.U., with which Western Germany had a very large surplus throughout the whole period. Dollar holdings fell during the first half of 1957, but, as Table IV shows, the gold reserve and E.P.U. claims rose sharply, and total reserves continued to expand.

TABLE IV

GOLD AND FOREIGN EXCHANGE HOLDINGS OF BANK DEUTSCHER LÄNDER

(million D.M.)

Items	31 December						31 May prov.
	1951	1952	1953	1954	1955	1956	1957
Gold and Foreign Exchange Holdings (net)	1523	4637	8714	10945	12806	17901	19943
of which:							
Gold	116	578	1367	2628	3862	6275	8079
Dollars	1418	2087	3543	5451	5788	7426	6866
E.P.U. Claims	100	1177	2369	2330	2605	3888	4767
Other holdings	−111	786	895	536	551	312	231

Source: Bank deutscher Länder.

II

According to the modern theory of balance of payments adjustment, an export surplus tends to be self-correcting as a result of its expansionary effect on national income. National income rises by some multiple of the export surplus, imports rise at a rate depending on the marginal propensity to import. In its simplest form, the theory shows that, ultimately, external balance is reached, imports having risen to equality with exports, the time taken for this to happen depending on the marginal propensity to import. If however, savings are taken into account, and they exceed domestic investment, there remains a residual surplus, financed in some way by the excess of savings over investment. This may be through private or public transfers to foreigners or through the import of gold. Whether the gold inflow leads to an expansion of bank credit, depends on the behaviour of the banking system, subject to the control of the Central Bank. As, however, banking liquidity increases and the gold reserve of the Central Bank reaches some satisfactory level, interest rates will ultimately be reduced and credit conditions generally will be improved. This stimulus to home demand will reinforce the direct expansionary effect of the export surplus and so facilitate adjustment. If imports still do not rise sufficiently, the imbalance will be corrected by a flow of capital in search of higher interest rates or by foreign import restrictions as foreign gold reserves fall to inconveniently low levels.

Modern theory lays great emphasis on the role of income changes in the adjustment process. Price effects, at least in the simplest form of the theory, are precluded, because it is assumed that there are sufficient unused resources and also fixed exchange rates. Most writers would agree, however, that price increases in the surplus country are likely to play some part and that it would be unrealistic to adhere strictly to an argument based on fixed prices and rising income. The existence of unused resources which can be drawn into employment is a fundamental part of the theory. They are a precondition of the rise in real income which leads to an increase in imports. A distinction is made between induced and autonomous imports. Induced imports are those which result from the rise in national income which is generated by the export surplus. Autonomous imports are those which result from changes in tastes, techniques, or government policy, or increases in home investment not induced by the export surplus, directly or indirectly.

In the German case there was no change in the exchange rate during the period under consideration. The condition of a substantial labour reserve was also satisfied. At the beginning of the period about 8% of the labour force were unemployed. Even more important were the large additions to the initial labour force through persistent immigration from Eastern Germany and the new entry of persons into gainful employment, a high proportion of whom were women. Between 1951 and 1956 the number of employed rose from 14½ to 18 millions, the number of unemployed fell from 1½ millions to half a million. The changes in employment and unemployment were gradual, as can be seen from Table V.

This makes an interesting contrast with the rapid changes in total employment and unemployment from the beginning of 1933 to the end of 1934. In that much shorter time unemployment fell by about three millions and employment, other than relief work, rose by about the same amount. A significant difference between the two situations, however, is that there were unused capital resources at the beginning of the 1933 recovery, whereas in 1951 it was probably still necessary to create the complementary real capital for the expanding labour force. This may be a partial explanation of the slower development in the post-war labour market, although it does not necessarily mean that different economic policies could not have helped to reduce the mass of unemployment more quickly than is shown in Table V.

Table V

	Gross National Product			Cost of Living Index 1950 = 100	Producers Prices (Industrial Goods) Index 1950 = 100	Unemployment % Annual average	Employed Persons 000s
	billion D.M.	% of growth over previous year					
			real value				
1950	90	13.1	—	100	100	8.2	13,827
1951	114	26.5	14.4	108	119	7.7	14,556
1952	126	10.9	6.3	110	121	6.4	14,994
1953	134	6.6	7.3	108	118	5.5	15,583
1954	146	8.3	8.2	108	116	4.7	16,286
1955	164	12.7	9.6	110	119	2.7	17,175
1956	180	10.0	7.1	114	123	2.0	18,056

Source: Bank deutscher Länder. *Annual and Monthly Reports.*

There was certainly a large increase in real income between 1950 and 1956. It amounted to about two-thirds over the period, with a minimum rate of growth of about 6%, rising gradually after the 1951 boom to its second peak in 1955. The part which exports played in keeping the expansion going obviously cannot be determined with any precision, but, as will be argued later, the sharp expansion of exports in 1956 must have been an important offset to the checks imposed by monetary and fiscal policy. However, it was not simply a question of a stagnant economy responding to

external stimuli. There were important domestic expansionary forces which could be regarded as the source of autonomous increases in imports. Government measures to assist private investment were particularly important in the earlier 1950's. A large amount of new house-building and reconstruction work boosted activity in the building industry. At the beginning of 1957 a substantial change was made in social policy which might have been expected to increase home demand and also the demand for imports. The persistence of the external imbalance, therefore, suggests that there must have been powerful influences which more than offset the effects of these domestic forces on the balance of payments.

The factors responsible for the strength of the balance of payments could be divided roughly into two categories; first, those of a structural nature; second, those resulting from current economic policies. The division is useful for exposition, but in practice the two were clearly interconnected. The next two sections will deal with each in turn.

One important point relevant to the foregoing sketch of balance of payments theory remains to be mentioned. The modern theory concentrates, as we have pointed out, on the functional relationship between imports and national income, and gives price effects a secondary role. In the German case price effects were in fact negligible. German prices fell slightly in 1953 and 1954, recovered and rose above their previous level in 1956, but even in 1956 they did not rise faster than prices in other leading trading countries. The rise in imports, therefore, owed little to relative price changes, but was determined primarily by the rise in real national income. The reduction of import restrictions certainly enabled the rise in income to make its effect on imports. If it led to any substitution of imports for home goods it was probably only on a small scale because it was quota limitations rather than tariffs which were removed. Further consideration is given to relative price changes in discussing the question of revaluation later in this paper. The significance of the minor role of price effects in correcting the imbalance is that the burden of adjustment fell on the response of imports to rising real income. As might be expected, this made adjustment more difficult than it would have been if income and price changes had been supporting each other.

III

This section will be concerned with the longer-run factors which have influenced the German demand for imports and the supply of and demand for German exports (2). As Table VI shows, German commodity imports have been a much lower proportion of gross national product than British imports. This has long been a normal phenomenon of the two countries' imports. During the 1930's the difference was even more marked as a result of the contemporary autarchic policies of the German government. It has been narrower in 1955-56 than in the early 1950's but one would have expected this from the extensive removal of quota restrictions, at first on trade with E.P.U. countries and then on trade with the dollar area.

Table VI

COMMODITY IMPORTS (f.o.b.) AS PERCENTAGE OF GROSS NATIONAL PRODUCT

Year	West Germany	United Kingdom
1949	—	18.0
1950	11.8	20.6
1951	11.5	27.4
1952	11.7	21.1
1953	11.0	19.3
1954	12.4	18.8
1955	13.6	20.4
1956	13.7	19.2

Source: Data from monthly reports of Bank deutscher Länder and U.K. Balance of Payments White Papers and Bluebooks of National Income and Expenditure.

The reasons for Germany's lower average propensity to import can be summed up briefly. First, domestic output of some basic raw materials, important in Britain's import bill, has been a high

(2) An interesting account of differences between the British and German demand for imports will be found in the 1953 *Economic Survey of Europe*, pp. 197-199. Considerable emphasis is placed on structural factors as determinants of British balance of payments weakness since the war and of German balance of payments strength since 1951.

proportion of consumption. Timber and petroleum are the outstanding examples (3). Second, a high proportion of Germany's consumption of basic foodstuffs is produced at home. Third, decades of protection, reinforced in the 1930's by a variety of Schachtian expedients, have probably conditioned the German economy to import-saving habits of production and consumption. These factors must have made it easier to expand without running into the balance of payments difficulties which have bedevilled Britain's post-war economic growth.

Whether Germany's dependence on imports will continue to rise depends on the outcome of several influences. It is possible that the liberalisation of imports which has been carried out in recent years may have delayed effects. With more freedom to import than for many years there may be changes in producer and consumer habits which will tend to raise the import content of industrial output and of consumption. Second, the low ratio of imports to gross national product has probably been influenced to some extent by changes in the pattern of industrial production, namely, by the more rapid growth of the capital goods than of the consumer goods industries. One might expect this from the fact that there is a lower percentage of imported raw materials in the production of capital goods than in the production of consumer goods (4). During the 1930's the output of capital goods showed a marked relative increase (5). In 1936, it has been estimated, it was about 13% above the 1928 level, output of consumer goods was 4% below the 1928 level. Although there has been a further shift towards capital goods in the 1950's, it has been accompanied by a rise in the ratio of imports to gross national products. The explanation is probably that there was a more than offsetting force in the removal of imports restrictions. Table VI shows how capital goods production shot ahead in 1951 and 1952, lost ground relatively in

(3) A comparison of British and German dependence on imported petroleum products reveals a remarkable difference. In 1954-55, according to the 1955 Survey of Europe, Britain imported crude and refined petroleum to the value of 896 million dollars, German imports amounted to only 206 million dollars. Imports of timber and wood-pulp were 729 and 289 million dollars respectively. On these product groups alone, therefore, the difference was over 1,100 million dollars.

(4) *Weltwirtschaftliches Archiv*, 1954 (Band II). See study by W. B. Hasselblatt, " Industrieproduktion und Rohstoffeinfuhr ", p. 269.

(5) *Etudes et Conjoncture*, March, 1957. See discussion of German industrial investment, " Les investissements industriels en Allemagne occidentale ", pp. 34-35.

1953, then again went ahead during the 1954-55 boom. By 1955-56, therefore, the German economy was much more orientated towards capital goods than in 1928, but pressure for better living standards may tend to change this bias.

Another factor which could be of some importance in increasing imports might be the inability of the domestic petroleum industry to keep pace with the growth of consumption, particularly by the private motorist. As we have already pointed out, German imports of petroleum have been remarkably low. This has been partly due to low consumption and partly to the growth of domestic output. Whether domestic output, which has supplied about one-third of domestic consumption in recent years, can expand sufficiently remains to be seen. One can only guess, therefore, at the future development of these influences, but it is probably reasonable to assume that the 1955-56 ratios of imports to gross national product are a better guide to Germany's current dependence on imports than the ratio of 11% in 1953. One would not expect it to approach the British level, however, unless there were a drastic change in agricultural policy.

TABLE VII

GROWTH OF WEST GERMAN INDUSTRIAL PRODUCTION (1936=100)

Year	Total excl. Bldg.	Basic Mats. & Producer Goods	Capital Goods	Consumer Goods
1949	89	81	86	86
1950	111	103	113	113
1951	131	122	147	129
1952	140	127	164	130
1953	154	137	173	152
1954	172	156	205	166
1955	198	181	252	184
1956	213	194	274	199

Source: Bank deutscher Länder, *Monthly Report*, July, 1957.

Great interest has also been aroused by the rapid growth of German exports since 1950. Several authorities have offered as at least a partial solution the favourable geographical and commodity

composition of exports (6). The Bank deutscher Länder put this view more strongly than did the Board of Trade, but it seems to have had a vested interest in exonerating its domestic credit policy from responsibility for the persistent imbalance. Nevertheless there can be no doubt that the composition of exports had something to do with the marked upward trend.

There is nothing new about this aspect of German trade. It has been a structural phenomenon reflecting a long-standing orientation of production and trade. A very high proportion of German exports has always gone to European countries and capital goods have always played a very important part. The post-war investment boom, therefore, naturally created a favourable milieu for the expansion of German exports. It was to be expected too that the post-war revival of exports would tend to occur in the old channels, unless blocked for non-commercial reasons. The same thing happened after the first World War, although the general economic climate was not nearly so favourable to the export trade. The geographical composition of exports also helped during the worst years of the depression. According to one estimate German exports would have fallen much more than they actually did if their geographical composition had been closer to that of the United States or of Britain (7).

In the 1950s dollar discrimination by E.P.U. countries has also led to some substitution of German for American capital goods. In this way the recovery of German export capacity helped Western Europe to reduce its dependence on American imports, but in doing so an unfortunate by-product in the form of a smaller version of the dollar problem seems to have been created.

Nevertheless, as the Board of Trade investigation has pointed out, the composition of the export trade is only a partial explanation of the great expansion in recent years. For a more satisfactory explanation other factors have to be looked for. There seems little doubt that the growth of the labour force was a vital influence. There is a sharp contrast between the large expansion of the German labour force between 1951 and 1956 and the very slow growth of the labour force in Britain, France and Belgium. It was

(6) Bank deutscher Länder. *Annual Report for 1956*, p. 8. Also *Board of Trade Journal*, London, Vol. 172, 30 March, 1957, p. 673.

(7) NEISSER and MODIGLIANI, *National Incomes and International Trade*, p. 49.

much easier for German industry to expand capacity and output than for industry in these countries. Moreover, the relatively easy labour position in Germany led to the quotation of more favourable export delivery dates than could be offered by many foreign competitors. The expansion of the German shipbuilding industry is a conspicuous example of the way in which favourable delivery dates, and the willingness (or ability) to quote definite delivery dates at all, have often been as important an element in competition as price in post-war years. Although the closer approach to full employment in 1956-57 tended to postpone delivery dates, German manufacturers did not lose their advantage in this respect. Even in 1956 it was still possible to increase the employed labour force by nearly 800,000, of whom manufacturing industry gained nearly half. Delivery dates, however, and the proportion of capacity available for export, are determined not only by the labour position but also by the relative pulls of the home and foreign markets. This raises the broader question of the effect of monetary-fiscal policy on the balance of payments.

IV

From the point of view of this paper the outstanding feature of German public finance during the years 1952-56 was the way in which the Federal government's tax receipts exceeded expenditure. From mid-1952 until mid-1956 there were only two quarters in which the Federal budget failed to run a surplus. Whatever deficits were incurred collectively by the Land governments were over-compensated by the Federal surplus (8). While the total quantitative effect on the growth of home demand is debatable, it was certainly in the opposite direction to what one would have expected if fiscal policy had been seriously used to help correct the external imbalance. It was shown in the second half of the 1956-57 financial year (9), however, that the balance of payments surplus could still

(8) The total surplus of the Federal government in the four years does not appear dramatically large. It amounted to a little under 7 billion marks, or about 1.7 billion dollars. The largest surplus (by calendar year) — 1.9 billion marks — occurred in 1955, the year in which the export surplus fell considerably.

(9) The financial year runs from April to March.

persist even with a considerable Federal deficit. In fact the rate of export surplus during that period was even higher than before. While this suggests that a much larger deficit was needed, it also suggests that one should look elsewhere for an important determinant of the external imbalance, namely to the repercussions of monetary policy.

There was no attempt at any time to influence the growth of home demand by what might be regarded as a cheap money policy according to post-war British standards. Interest rates were generally higher than in other European countries. Throughout 1951 and up to May, 1952, bank rate remained at 6% and was supported by higher minimum cash reserves ratios for the commercial banks than in 1950. During this phase there was a particularly wide difference between German and foreign interest rates, since the general move towards dearer money policies had only just begun. In view of the small international reserves at that time the Bank deutscher Länder's policy is less open to criticism than it was later. It must be remembered that the reserves had to be built up virtually from nothing, as can be seen from Table IV.

In the second phase, which lasted from May, 1952 until August, 1955, there was a gradual relaxation of the previous policy. Bank rate was progressively cut to a minimum of 3% and easier reserve ratios were prescribed for the commercial banks. The fall in interest rates was most marked in 1954; the rate at which new industrial bonds were issued, for example, fell from 8% to 6½%. But the Bank deutscher Länder did not try to force the pace as interest rates tended to fall nor did it try to counteract whatever restrictive effect the Federal budget surplus had on the growth of home demand. Its declared aim during this phase was simply to conform to the natural development of credit conditions through the expansionary effect of the export surplus and the growth of private savings, but only for as long as the general price level satisfied its criterion of stability.

The third phase began in August, 1955, when bank rate was raised to 3½%. Subsequently, in March and May, 1956, it was raised to 4½% and 5½%. The higher rate was supported again by higher minimum reserve ratios and also by increased use of open market operations, the scope for which had been expanded by a substantial addition to the Central Bank's supply of marketable securities in anticipation of a change in monetary policy. In addition, an important change was made in the method of operating the system of rediscount quotas which had originally been introduced in 1952. Under this system a commercial bank's borrowing facilities at its Land Central Bank depended on its volume of lending, provided its holding of bills eligible for rediscounting grew pari passu with its total loans. Under the modified scheme the volume of credit ceased to be a factor determining quotas and an increase in quotas was made more difficult than before. The banks lost, therefore, the right to virtually automatic access to Central Bank credit as their loans increased. The Bank deutscher Länder continued to sell home currency for foreign currency on a large scale, but as a result of its open market operations and the above-mentioned restrictions it contrived to neutralise to a considerable extent the expansionary effect of the large export surplus in 1956 and 1957. Moreover, by keeping interest rates relatively high in 1956 compared with rates in several European countries, it added to the balance of payments problem by attracting foreign short-term capital, and by inducing German traders to finance more of their imports through borrowing in centres where interest rates were lower (10).

It is certainly true that even the switch to a dearer money policy did not prevent the expansion of gross national product. In fact, as Table V shows, it was not much below the 1953-54 rates. But in 1956 it seems to have depended more on the stimulus of exports than in previous years. The current account surplus rose to 3.3% of gross national product compared with 2% in 1955 and 2.6% in the two previous years. In the first half of 1956 the capital goods industries benefited particularly from the buoyancy of the export market. Export orders rose by about 16% over the corresponding period of the previous year compared with an increase of only 5% in home orders. The value of exports of capital goods increased by 26% in 1956 compared with increases of 18% and 20% in 1955 and 1954 respectively.

In general, throughout the whole period, the growth of home demand seems to have been kept sufficiently below the growth of

(10) It is important to bear in mind that the primary strength of the balance of payments was derived from the visible trade balance. Apart from the abnormal conditions of 1957, the importance of short-term capital inflows of various kinds was relatively small compared with the large and persistent visible trade surplus.

productive capacity to leave a substantial potential margin for an export surplus. This surplus did materialise because other countries in Western Europe supplying competing goods were less successful in increasing their exports or in meeting home needs, and the rapid growth of world trade in general provided, as we have already pointed out, a very favourable environment for the goods which Germany was best able to produce and for which exactly the right capacity was available. It was not simply the outcome of a difference in inflationary pressure in Germany and abroad, although that was undoubtedly an important factor. Britain pursued a less expansionary policy than other European countries in the 1920s but did not thereby enjoy a strong balance of payments. The British difficulties were partly due to an over-valued currency and too high a rate of foreign lending. They were also accentuated by the structural problem that a relatively small proportion of exports and of productive capacity belonged to the industries the demand for whose goods was expanding most quickly in world trade. In the second and third respects the German position was very different; so far as the exchange rate is concerned, the mark was at least not over-valued. Further consideration will be given to the questions of foreign lending and revaluation in the next section.

From the point of view of the balance of payments there was certainly no obstacle to an expansionary monetary-fiscal policy, at least after four years of surpluses had built up the Central Bank's international reserves to over 10 billion marks, or approximately 60% of the value of imports in 1954. The main obstacle, once reserves were reasonably adequate, by current European standards, seems to have been the very strict insistence by the Central Bank on stability of the general price level as the overriding objective. This attitude, together with the unwillingness of the Ministry of Finance to spend for other purposes the unspent funds which had been earmarked for occupation or defence costs, probably prevented a higher rate of growth in 1952, 1953 and 1954 than was attainable, even without seriously compromising the objective of price stability. It is significant that unemployment was still fairly high throughout 1954 and there were other important sources of fresh labour. It is noteworthy that the annual growth of the employed labour force in 1952, 1953 and 1954 was considerably below its growth in 1955 and 1956. Moreover, the growth of industrial production by 10% and 11% in 1953 and 1954 does not appear outstandingly high if one compares it with the 11% and 8% growth of industrial production in Britain in 1948 and 1950, given the much greater ease with which German producers expanded their labour force.

If it is reasonable to assume that output and employment could have been expanded more quickly, then the same would probably have been true of imports. It cannot be assumed, however, that the external imbalance could have been corrected solely by measures of monetary-fiscal policy, at least if we exclude measures which would have created serious inflationary pressure. It would obviously be an unreasonable rule of international economic behaviour which obliged a creditor country to expand home demand without limit until its surplus was wiped out. On the other hand it seems also unreasonable that budget surpluses and credit restrictions should be characteristic of a creditor country without the use of effective alternative methods of dealing with the external imbalance. If by 1955 or 1956 the rate of increase of prices were regarded as the maximum tolerable, and for that reason a more rapid growth of demand was undesirable, then alternative methods of dealing with the imbalance should have been evolved as a matter of urgency.

V

In this section we shall consider the extent to which alternative methods were used and the problems which they involved.

First, capital exports and their modern offshoot — government grants. Direct business investment abroad was subject to licensing, but licenses were liberally granted. The purchase of foreign securities, however, by Germany residents was not permitted until 1956 (11). Details of foreign investment by German firms are given in Table VIII. Total business lending over the 5½ year period was small compared with the annual rate of growth of the Central Bank's reserves. The total for 1956 was barely half the growth of the reserves in the first quarter of that year, 383 million marks compared with 686 million marks.

The other main item of capital transfers was the amortization of old debts which amounted to 648 million marks in 1954, 517 in 1955 and 452 in 1956. The maximum deficit on all medium and long-term capital transactions, however, was only 717 million marks (180 million dollars) in 1954 compared with a current account surplus of nearly 4 billion marks (one billion dollars). The corresponding figures for 1956 were 540 million marks (135 million dollars) and 5.5 billion marks (1.35 billion dollars).

(11) Negligible use seems to have been made of this concession up to the time of writing.

Table VIII

GERMAN CAPITAL INVESTMENT ABROAD
(*million D.M.*)

Period	Continental E.P.U.	Sterling Area	Dollar Area	Others	Total
1952	3	2	1	10	16
1953	19	3	8	15	45
1954	90	17	40	43	190
1955	77	28	88	61	254
1956	127	38	136	82	383
1957 January-June	—	—	—	—	274
Total	316	88	273	211	1162

Source: Bank deutscher Länder. *Monthly Report*, June, 1957.

In addition, however, there were large and increasing income transfers mainly for reparations, against which could be set only a small amount of foreign aid. The balance of income transfers (donations in the German accounts) became negative in 1953 and reached 1.1 billion marks in 1956. Nevertheless, the total deficit on income and capital transfers amounted at its peak to less than half the current account surplus in 1955 and less than one-third the surplus in 1956.

It must be conceded that these figures do not give a complete picture of the extent of German unilateral payments in recent years, since they take no account of public lending through the E.P.U. A considerable part of the Central Bank's reserves consisted of E.P.U. balances, which represented in effect credit extended to members of the Union. In absolute amount this loan continued to grow from 1951 onwards, depending on the size of the E.P.U. surplus and the credit-gold ratio. In 1953 and 1954 when the 50-50 ratio prevailed, about 220 million dollars' credit was extended to the Union, in 1956, however, with a 25-75 ratio, credit amounted to 250 million dollars but three times that amount was drained from the Union. At mid-1957 the credit outstanding amounted to 880 million dollars.

As a means of increasing the supply of international credit the high credit-gold ratio was undoubtedly a valuable feature of E.P.U., but it was apparently unsatisfactory to the German government, who was foremost in pressing for a reduction in the liability to grant credit for a given surplus. It is of course understandable that an automatic liability should be unwelcome to a creditor country, particularly if it is likely to extend beyond a certain limit. But, in this case, the persistent imbalance in German trade with the E.P.U. countries reflected a natural bias which had to be offset in some way, if not by an opposite imbalance in trade with the rest of the world, then by some forms of settlement which financed the surplus.

It must be admitted, that there have been important obstacles to large scale German participation in international lending or in international aid schemes in recent years. First, it has been an outstanding characteristic of the post-war international economy that the flow of government loans and grants, and also of private loans, has largely been directed towards countries with special political relationships to the countries supplying the funds. Most British and French loans and grants have been confined to the Sterling Area and French Union respectively, and have been spent in the metropolitan countries. American funds have been more widely distributed but they have still fitted into the general framework of foreign policy, and a high proportion has been restricted to spending in America. Germany, on the other hand, has not formed part of a currency and political bloc like the Sterling Area or French Union which would create a sense of obligation (and self-interest) to participate in foreign economic development, even at the expense of domestic consumption or investment. Nor have considerations of foreign policy and humanitarianism caused large flows of funds as in the American case. Moreover, what might have been an important outlet for German investment, namely Eastern and South-Eastern Europe, has been cut off by the division of Europe.

Second, it has been assumed in Germany that capital has been too scarce for home development to leave a big margin for foreign investment. It is true of course that the ability to generate a large export surplus does not necessarily mean the ability (or the willingness) to export long-term capital on private account. But by what criterion could Germany be judged short of capital? One cannot take high domestic interest rates as the criterion, since they were due to a large extent to budget surpluses and the failure of the Central Bank to expand credit as its international reserves increased. Nor if one makes a rough comparison of Germany's real capital needs with those of other European countries, is it evident that the real capital shortage was greater, at least in the later years of the period, than in, say, Britain or France.

While German interest rates were certainly high relative to rates in a number of European countries and this differential did tend to attract foreign funds (12), it does not follow that lower rates would have led to a much greater volume of private foreign investment by German citizens. Several reasons may be given for this view. First, a lot of private foreign investment by other countries has been designed to exploit mineral concessions, the market for which is imperfect. Political considerations have played an important part in the sharing out of concessions by the countries in whose territory the minerals are located. Oil concessions are a conspicuous example. Until recently, firms of British, American and Dutch origin have held most of the concessions in the leading countries whose oil resources have had to be developed with foreign money. This fact may have been important in keeping German firms out of a field in which high prospective returns might have attracted a lot of German funds.

Second, it might be argued that German investors are even less interested in buying foreign assets than investors in other industrial countries because of the long interval since they last participated in international investment on any scale. It must be remembered that the great period of capital exporting by Germany had ended

(12) The Bank deutscher Länder tried to stop an influx of funds due to the interest rate differential by forbidding the payment of interest on foreign money in German banks and by requiring them to have a higher cash reserve ratio in respect of foreign funds than of domestically owned funds. This could not stop the inflow of funds based on expectations of a revision of exchange rates.

even before 1914, and most of the assets acquired then were lost during the First World War. Information about new lending during the inter-war period is very inadequate, but it has been estimated by the Wiggin's Committee that total German foreign assets in 1930 were only between nine and ten billion marks, invested mainly in Latin America, South-east Asia and Eastern Europe (13). It seems unlikely that there could have been an increase in the amount during the depression or the later 1930's, if we exclude the assets acquired through Germany's expansion in Europe before the last war.

Third, the German capital market has recovered only slowly since the war. The institutional machinery for raising foreign loans in Germany has been even slower in developing. Before 1914 a particularly important part was played in this respect by the large banks; for example, in negotiating loans for foreign governments, in setting up companies for developing foreign resources and in helping existing firms to expand their foreign operations (14). In fact the banks were perhaps even more important in foreign investment than in domestic investment. The dislocation of foreign banking connections of the German banks during the first World War and the financial problems of the 1920's diverted the banks' interest from foreign lending, while the balance of payments was in any case too weak to stand a substantial amount of new lending. The major disruption of the banking system after the last war is probably still a factor in the weakness of the institutional machinery for foreign lending. Whether the emergence of larger banks under recent legislation will correct this weakness remains to be seen. It is an indication of industrialists' concern with the position that a proposal should have been put forward for a West Germany Export Bank somewhat similar to the successful American Export-Import Bank.

One may still doubt whether private lending either by private individuals or by businesses is likely to increase sufficiently to reduce the need for government loans or grants. This has not been true

(13) See C. R.S. Harris, *German Foreign Indebtedness*, 1935, p. 10. In sterling this was equivalent to between £400-£450m. of which only about £150m. was in long-term assets.

(14) *Cf. Joint Stock Banking in Germany*, by P. B. Whale, for a good account of the activities of the Credit Banks in pre-1914 German lending.

in the American case. Opinions may differ about what would be a " reasonable " flow of capital and grants from West Germany, but it should probably not be too much to expect an amount somewhat similar to British contributions to foreign economic development. This would certainly imply a much higher rate of private lending than in recent years. British private lending even with a relatively weak balance of payments has probably averaged between £100 and £150 millions a year. If private lending failed to muster up to the necessary scale it would also imply a higher rate of public transfers. The technical forms which public transfers might take clearly require close study. The proposed German participation in African economic development is one possible approach, the proposed European investment bank or fund and the International Bank (together with its associated Finance Corporation) are other channels which might be exploited (15). Probably more could be done too in the way of loans or grants negotiated directly between the German government and countries which are short of foreign currency for their development programmes.

Second, the reduction of import barriers. Liberalisation of commodity imports from E.P.U. countries reached 81% by the end of 1952 and 91% by the end of 1955. Agricultural imports remained subject to quantitative restrictions. Liberalisation of dollar imports was slower, but reached 68% by the end of 1955 and 93% by the end of 1956. At that date commodity imports were subject to fewer restrictions than at any time since the depression.

The removal of import quota restrictions was the easiest way of liberalising trade, since, apart from the agricultural quotas, they were not designed to have a protective effect. Tariff reductions are usually a different proposition. As American experience has shown, it is difficult to effect drastic modifications of tariffs in response even to a persistently strong balance of payments. The

(15) The International Bank borrowed 100 million dollars in American currency from the Bank deutscher Länder in July, 1957. It is curious however that no change was made in the German quotas at the Bank or the Fund. At that date the German quota of 330 million dollars was well below the French or the Benelux quotas, and still further below the British quota of 1,300 million dollars. In any revision of quotas, which affect both the commitment to lend and the right to borrow, one would expect the German quota, particularly at the Fund, to be scaled up to a more realistic level.

Another method belatedly adopted in 1957 was the advance repayment of debt and advance payment for imports of armaments. As a temporary measure it was also agreed to give credit to E.P.U. beyond the limit of Germany's quota.

arguments for protection of individual industries tend to outweigh the arguments for freer trade as a means of assisting the adjustment process. Nevertheless it has been possible to reduce tariffs on a broad range of industrial goods by 25-50%. One would expect some tendency, therefore, to substitute imports for German products. But it would probably be a mistake to expect a great deal from the tariff cuts. It is probably no more likely to correct the German imbalance than similar reductions of American tariffs would solve the dollar problem. A lot depends on the proportion of total imports affected by the tariff cuts. Since in the German case they cover mainly manufactures, which are only a relatively small proportion of total imports, even the ultimate increase in the import bill may not be very significant (16), although it would of course be a useful element in a complete solution.

Most controversial of all the methods of adjustment is revaluation. As post-war discussion has proved, it is very difficult both in theory and in practice to determine satisfactorily under what conditions a balance of payments disequilibrium is such as to require revaluation. The German case was no exception. So far as relative export prices were concerned, there was certainly a tendency for German prices to lag behind the prices of leading competing countries, as Table IX shows. It has also been suggested that German export prices tended to be higher than home prices so that, in some industries at least, there was an incentive to seek foreign markets. The extent to which relative prices can be taken as a criterion of revaluation is debatable, but even if they were so used in the German case they would not point to a large appreciation and one may doubt whether a small appreciation would have made an important, if any, contribution to correcting the imbalance.

The main argument for appreciation was ultimately that there appeared to be no other way of dealing with an apparently intractable surplus, given the difficulties of financing the surplus and the attitude of the German authorities to an expansion of home demand. This could be regarded, however, as unsatisfactory from the strictly economic point of view, depending on the importance attached to the structural elements in the problem. It is true that revaluation

(16) Finished manufactures in 1956 accounted for 8% of total imports. Semi-finished goods accounted for another 29%. The rest was foodstuffs and industrial raw materials.

may assist other methods of dealing with the structural aspects, but in general structural problems require structural solutions.

One would expect revaluation to reduce the relative attractiveness of the export market, and so to weaken any incentive to give more favourable delivery dates for export than for home orders. But even given these favourable results for the adjustment process, the German balance of payments would still have had strong basic sources of strength in the geographical and commodity composition of exports, in the bias of the production pattern towards capital goods, and in the effects of historical protectionist policies on the production pattern.

TABLE IX

EXPORT PRICES OF MANUFACTURES (1953=100)

Year	West Germany	Belgium	United Kingdom	France
1955 1st Quarter	98	95	100	92
2nd »	98	97	100	97
3rd »	98	96	102	96
4th »	98	96	103	96
1956 1st Quarter	100	102	104	98
2nd »	102	104	104	101
3rd »	102	102	105	102
4th »	101	104	106	102
1957 1st Quarter	102	—	106	—

Source, O.E.E.C. *Foreign Trade Statistical Bulletin*.

It has been increasingly recognised, therefore, that capital transfers can make a major contribution to the German problem, as they have to the dollar problem. This paper has also emphasised this line of approach, while not attempting to minimise the difficulties of making Germany one of the major suppliers of development funds on a par with Britain. It is true of course that even with a much higher level of capital exports there could still be conditions in which, temporarily at least, Germany's export surplus grew faster than the net outflow of capital and grants, as appears to have happened with the American balance of payments in the first half of 1957. In the absence of a commitment to adjust the capital outflow along the lines suggested by the United Nations Report on " National and International Measures to Maintain Full Employment " such a situation is likely to swell Germany's international reserves at a rate inconvenient for other European countries (17). Such a situation would probably have to be tackled by changes in monetary-fiscal policy both in Germany and abroad. But one would not expect the rate of growth of reserves to be as great as in 1956-57 if the channels for making foreign loans and grants were more fully developed, if the labour supply position were less easy than in recent years, and if Germany's defence commitments approximated more closely to those of other European countries.

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(17) *United Nations Report*, 1949, pp. 90-92.