

Has Western Germany a Liberal Market Economy?

by

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I

Western Germany has 50 million inhabitants — as many as Great Britain. It has also the same area, and thus the same density of population, *i.e.* 200 per square kilometre. Three-fifths of its soil are arable land and meadows, or that is, 2,800 square metres per head — a tiny piece of land. The other two-fifths are covered by woods and moors, lakes, rivers and bogs, rocks, roads, and houses. The land of Western Germany is cultivated intensively by relatively small undertakings. As a result the yield is twice as high as in the United States per acre, but only half as high per head of the agricultural population, and probably only one-fourth as high per working hour. Thus, the agricultural population of Western Germany is relatively numerous; it constitutes a good quarter of the whole German population and is four times as large as the British agricultural population. In spite of the heavy use of labour, the home production of food is sufficient for only 60 per cent of the population of Western Germany. The same is true for wood. Coal is the only product of the soil which exists in sufficient quantities. There is little iron, potash, and oil, and practically nothing else; no non-ferrous metals, no bauxite, the source of aluminium, nor even good China clay. In short, the land is scarce and the soil is poor.

The people of Western Germany are at the present time of an unusual composition. In the most efficient working age-group of 20-40 years, a million men are missing, whilst the less efficient group is relatively more numerous than before the war. Both these facts help to reduce the average output of the workers; it is 20 per cent lower than in 1938, and about

10 per cent lower if we make allowance for the effect of the poorer provision of equipment. Of the 50 million inhabitants of Western Germany, 9 million are refugees from the East, and two-thirds of these are unfit for work. The refugees live for the most part where the houses have been least damaged by bombs, that is in the country districts. But just in those districts there is little work for them. In the industrial districts, on the other hand, housing is lacking. This is already one cause of unemployment. This fact and the higher than average proportion of the unfit, contribute powerfully to the heavy expenditures for public assistance, which now amount to 13 per cent of the net social product at factor cost. At the present moment over 13 million people in Western Germany are in receipt of help from public funds. To sum up: the potential social product is diminished by three factors: the abnormally high number of the unfit; unemployment; and the low output per head of the employed population (1).

The productive apparatus left in the Western Zones after the partition of Germany in 1945, was, in spite of the damage wrought by the air and land war, still as large as the corresponding one of 1938, or perhaps even larger if we judge it merely by the number of machines and building units. But size alone tells little. The war, by destroying single machines, single buildings, single concerns, had riddled the machinery of production. The dismantlings had continued the same process by other means. In addition, the wear and tear of the first three years after the war generally ex-

(1) Most recent figures obtained from: *Deutsches Institut für Wirtschaftsforschung* and *Bank deutscher Länder*.

ceeded what was made good by the meagre repairs. Hence the productive apparatus was probably smaller in 1948 than in 1938; it was in a poor state of repair and was for the most part technically out-of-date. And what was especially important, its composition was distorted. This last circumstance was due to four different causes.

Since 1936, while certain industries, important for armaments had, it is true, considerably enlarged their plant, by no means all had done so, as, for example, the coal industry. Other branches, in the so-called civilian sector, had even shrunk. In both cases the reason lay in the direct controls. The second cause of the distortion was the price-stop; until the middle of 1948 the prices of 1936 were still enforced, and the more strictly the more « essential » the article was considered to be. These prices, however, had for a long time ceased to correspond to the real scarcity relations, and so had the productive apparatus in so far as it was geared to these prices. The third cause of the distortion was the cutting off of the Russian Zone with which the economy of Western Germany was formerly complementary. The fourth and last reason was the isolation of Germany from the outside world over the preceding ten years. In short, not just small, but mutilated by the war and the dismantlings, distorted by the effect of the price-stop, the war economy and the partition, worn out and out-of-date — that was the condition of the productive apparatus of Western Germany in 1948. This was not only true of the machinery of production taken as a whole; one or more of the features of this description applied to each individual concern.

The technical knowledge and skill of the population of Western Germany was formerly about on the same level as in other industrial countries. But the unequal development between 1936 and the end of the war, and the cessation of research since the war have caused it to lag behind. To-day Western Germany takes technical advice and manufacturing licences in large measure from abroad, without, as formerly, being able to give equal return.

To sum up: 50 million people with technical knowledge and skill, living on an area which can feed only 30 millions and from

which the only raw material yielded in sufficient quantity is coal, and equipped with a machinery of production which is worn out and for the most part out-of-date, mutilated and distorted — that is the constellation of circumstances characterising the economy of Western Germany in the middle of 1948.

What was to be done in this situation in order to bring production and supply as quickly as possible up to the optimum? The employment of still more labour in agriculture, which was already highly labour intensive and had already reached an advanced stage of diminishing returns, promised little. And there were no waste areas that could be taken into cultivation. Agriculture was also the least likely sector of the economy from which an increase in the productive power of the workers through better nutrition might be expected. What agriculture needed was first, more and better equipment instead of valueless paper money in exchange for its produce, and secondly, capital, in order to restore the exhausted soil and the worn-out equipment at least to their pre-war condition. Thus the key to improvement in agriculture lay with industry. But even with a maximum expenditure of effort, the agricultural produce of Western Germany would only suffice for 30 of its 50 million inhabitants.

The other, far more powerful means, for the improvement of the standard of living, is the export of manufactured goods in payment for the food and the raw materials which cannot be produced at home. And this indeed presents the only possibility of giving full employment to the whole population with a reasonable level of remuneration. The export trade in finished goods is always more variegated than that in raw materials or half-finished goods; and the export trade of Western Germany must be especially highly differentiated, on account of the large number of relatively small concerns, the greater necessity for them to meet the special requirements of customers than is the case with their great competitors, and the fact that they do not occupy a favoured position in the world market. Many thousands of articles and qualities are on the selling list of Western Ger-

many, and the number of daily sales contracts is correspondingly large.

Export trade of this kind calls for a productive apparatus which can deliver goods of high quality, and in which the individual concerns can adapt themselves swiftly and exactly both to each other's requirements and to those of foreign markets. It thus needs people with a spirit of enterprise, expert knowledge, industry and application. It also needs adequate capital for repairs, replacements, and the enlargement and adaptation of the productive plant in response to the new, completely changed data of the economic process. Exports (with of course corresponding imports) on the one hand, and the creation of capital on the other, are therefore the two prerequisites for achieving a standard of living which from a modest beginning gradually rises to an optimum level. These are the two great needs of Western Germany. It may be very roughly estimated that a standard of living equivalent to the average standard of Western Europe would require, on the one hand, additional capital of some DM 100 billions (60 for industrial concerns, and 40 for housing) and, on the other hand, annual exports of DM 15-20 billions at the price level of 1950 in order to finance corresponding imports. (Great Britain with a territory and population of equal size imported DM 31 billions worth of goods in 1950, of course with a standard of living considerably higher than the West European average).

Western Germany will therefore have to organize its economy with the aim of promoting exports and capital formation: this is the inevitable consequence of the constellation of circumstances which has prevailed in the West German economy since 1945. In other words, the ability to expand exports and to increase the provision of capital will be the criterion for deciding what is the best type of « economic order ». Which is in fact the best from this point of view?

II

We have had in Germany a considerable amount of experience with different types of « economic order ». In the 'twenties we be-

came acquainted with the degenerate market economy in which the steering mechanism was partly put out of order by innumerable monopolies and rapidly increasing import duties, with as a result falling productivity and rising sensitivity to crises. In the 'thirties we experienced the next step, the 50 per cent centrally-planned economy. It gives the appearance of being very successful, is much praised and recommended at the present time, and is characterised by slow permanent inflation combined with price-stop on the domestic market, which produce full employment, and by export-drives and exchange control in the foreign market, which are clumsy and expensive. There was in 1936 a well organized export-drive, which involved the elimination of competition between German firms, and subsidies, the level of which was continuously adapted to market conditions in each single country for each single article and each single quality; and, none the less German exports did not at that time rise more rapidly than did the exports of other countries which did not have this complicated and expensive apparatus. Soon physical controls also became necessary. A pretty system arose with transferable quotas of iron and other important raw materials, a so-called « Kernplanung » (core-planning, if literally translated). This system, of course, was mainly based on the figures which the degenerated market economy had provided, and, moreover, the workers and employers did not yet know that their rising savings accounts and bank deposits, the reward of their efforts, would some day vanish instead of providing them with a carefree old age. The success of this highly unstable intermediate stage was due for the most part to the transitory inheritance from the market economy: the rational and consistent economic structure, the initiative and high quality of the work. The tendency for the element of central direction to expand in this « 50 per cent system » is powerful, and is strengthened by every change in the data governing the economic process. In time, the inherited distribution of the economic quantities no longer suffices; and there must then be real central planning and direction. This exposes the defects. Neither the quantities of goods, nor the dates of output

are the appropriate ones. Moreover, indifference, quality deterioration and waste become widespread, and call forth exhortations from Ministers of the Government as a substitute for the inducement of full shop windows.

We are well acquainted with the next step, the 100 per cent centralized direction and planning of the war-economy. It benefits from the inducement of patriotism and other weighty incentives. It has the advantage that the army is from the outset a totally centrally-directed machine with priority over everything else; this fact greatly simplifies the task of planning as long as there exists an «unimportant» civilian section from which the foreseen and unforeseen deficits of military planning can be made good. The moment this civilian section is exhausted, of course, the impossibility of making an exact distinction between degrees of «importance» and «unimportance» becomes apparent.

We have come to know the third variety of central planning since the end of the war, a variety which is without patriotic motives. A multiple system of centralised administrations, one in each Zone, planned complete chaos, on the basis of the prices of 1936. The contravention, either arbitrarily tolerated or subject to severe punishment, of instructions gradually led to the growth of a black market, without which this «planning» would have broken down sooner, and more terribly than it actually did. Under this form of control a steady consumption of capital took place. The index of production stood in the middle of 1948, three years after the end of the war, at only 44 per cent of the 1938 level. This figure, however, gives a much too favourable picture because it fails to take account of two highly important properties of the goods — their quality and their ability to satisfy wants. This is sometimes overlooked, and false conclusions are drawn. The 44 per cent was made up, in good part, of souvenirs, expensive ash-trays and similar articles, of textiles which tore after a single day's wear, or shrunk to half their original size, of shoes with cardboard soles, and of repairs of repairs. A workman needed at that time only a sixth of his pay to buy his legal rations, and therefore at the most only one member in a family worked. But there

were no unemployed, for the rest of the family made long tramps on foot or excursions by train to exchange a pan, a shirt, a sheet, or anything of immediate usefulness for a tiny quantity of food. It took a thousand hard working people to do in one day as much as could have been done by a lorry with two drivers. Only a quarter of the exports at the beginning of 1948 consisted of manufactured goods.

Experience shows that a mixture of centralised direction and market economy carries in itself a powerful tendency towards the extension of the centralizing elements, that the centralised direction is incapable of closely adjusting a complicated machinery of production to new data; that initiative and the striving after quality decline in proportion to the part taken by the central direction, and that finally the will to save gradually dwindles. If, however, exact adjustments of the productive apparatus, initiative, a striving after quality, and the will to save, are the conditions for export and the formation of capital, then any economic order which embodies a considerable measure of central planning and direction is unsuitable for Western Germany.

By reason of these experiences, and especially of those of the 50 per cent economy, some people in Western Germany have been endeavouring since the middle of 1948, in spite of opposition at home and abroad, to develop the market economy as the prevailing «economic order». The first decisive measure was the Currency Reform. Logically consequent upon it was the freeing of many markets from central control. What was the result of this attempt? The relative prices of the freed industrial sector have adjusted themselves in conformity with the new data of the West German economy; they again reflect the relative scarcities of goods and have led to corresponding adaptations of production programmes. The degree of satisfaction of wants which the average working hour has given since the reform has for that reason alone risen considerably. The volume of industrial production has increased and, what is equally important, its quality has substantially improved. The index of production indicates only the first of these

two aspects and does not thus measure the full extent of the progress made. The index rose from an average of 49 in the first half of 1948 (the Currency Reform dates from 21st June, 1948) to an average of 139 in the second half of 1951. Exports rose from DM 600 millions in the first half of 1948 to DM 7,800 millions in the second half of 1951. The proportion of finished goods in the total increased during these three and a half years from 30 per cent to 77 per cent. This shift of the output stream towards exports of finished goods took place without any «export drive», and without subsidies or other measures for influencing private decisions.

This result exceeds all expectations and is exactly in the necessary direction. It demonstrates once again the capacity of the price mechanism of the market economy to coordinate, and give a rational direction to a complicated productive apparatus. It confirms the correctness of the considerations which led to the choice of the market economy as the most appropriate economic order.

What is remarkable in this development is the rate of increase in the production curve, not the level reached so far, which is still below the West European average. The increase is the more remarkable in that the reform of 1948 was not complete. Important markets are to-day still under government control, and it is precisely these which have lagged behind the progress of the whole. The entire coal industry is excluded from the competitive sphere; the price of coal is fixed by the authorities and the output is subject to allocation. Housing is strictly controlled, rents being fixed below cost. The whole transport system — railways and motor transport as well as the postal service — is strictly monopolised under government authority. The prices of important agricultural products are also fixed by the authorities.

III

The other great need of Western Germany is the formation and effective distribution of capital. We shall now briefly consider what happened in this sphere.

It would be in keeping with the principles

of the market economy if business profits were paid out to the owners of the firms earning them and these persons were taxed like everyone else, but in a measure such as would allow, through savings, the creation of capital commensurate with the size of the income. It is certain that saving would take place under these conditions. The savings would flow into the capital market, where, independently of their origin, they would be distributed by a suitable banking organisation according to the usual considerations of security, earnings, and future prospects. Through the general competition between the managers of firms for new capital, the relationship between managers and owners would be justly balanced.

But the economy of Western Germany since the middle of 1948 has been different from this. The amount of dividends that may be paid out has been limited by law to a maximum of 6 per cent. A complicated system of taxation works in the same direction. The profits of a concern are in the first place curtailed inside the concern by a capital and a profits tax. Both are proportional, and thus produce together a slightly regressive rate which at the minimum is just over 60 per cent (on a return of 10 per cent, for example, the tax amounts to 70 per cent of the profits). What remains of profits, in so far as they are distributed to the owners, is subject again to the capital tax and in addition to the steeply-rising income tax. This results in the following situation: if the profits are not distributed the concern will get 30 per cent, the owner nothing, the State 70 per cent; if they are distributed, the concern will get nothing, the owner next to nothing, the State practically everything. The objection might be raised that if the profits are retained, the 30 per cent is in reality added to the net worth of the owners, and is thus equivalent to the transfer of income to the future. The socialising tendencies in Western Germany, however, reduce this increase in wealth to a very doubtful prospect. Since all capital invested at a fixed rate of interest was reduced to one-twelfth by the currency reform, the net income derived from such capital has practically disappeared. The result of this is a rigorous levelling of net incomes. The worker has to-day again the

same real income level as in 1938; officials and employees have on the average about 80 per cent of that level; all other medium and higher incomes have been reduced to a fraction of the level of 1938, the smaller the higher they are. In consequence the capacity to save of individuals is limited to relatively small amounts, e.g. for a life insurance or a house, or a savings book.

The other side of the picture of this levelling of net incomes is the dwindling to insignificant proportions of the capital market. In the three years following the currency reform which took place in the middle of 1948, long-term securities up to the total value of DM 2,670 millions were issued in Western Germany, but only DM 1,800 millions have been sold. Of this amount DM 600 millions went to industry. In addition there were made available during these three years, a further DM 3,600 millions of long-term credits not in the form of securities, DM 1,000 millions of German, and DM 2,600 millions of American origin. On the whole therefore the tiny sum of DM 530 millions annually of German long-term capital of all kinds was placed at the disposal of the industry of Western Germany by the capital market.

The total capital formation was, however, greater than this; as a consequence of the above-mentioned measures, and of some minor alleviations concerning depreciation allowances, it was shifted mainly to the business concerns and, to a lesser extent, to the public authorities. It is estimated that since the currency reform an annual average of about DM 8,000 millions have been invested directly in the firms of Western Germany out of their own funds. The condition for this kind of investment was a profit-making business. The higher the profit, the greater was the possibility of capital formation and of investment; indeed it was more than proportionately greater. The mechanism for taking away profits both from the firms and from the owners acts as a dam, against capital outflow and inflow, round each individual firm. The reservoirs are filled to different levels. Individual firms are able to extend investment much further down the curve of diminishing marginal returns than is the case for the average. Between the different

reservoirs there is dry land. The management of the concern sits inside the wall, the owners outside.

What has been said concerning the damming up of long-term capital, holds good, in principle, also for short-term capital; here too the yield is lessened by the artificial keeping down of interest rates. By federal law, all the commercial banks have been grouped into a single organisation, a kind of compulsory cartel, which is practically controlled by the Central Bank. But not only the group as a whole but also each individual bank is as a rule dependent upon the Central Banking System because of the need to rediscount. The Central Bank has hitherto used this dependence for a fairly strict though elastic credit control, specific direction being, however, only occasionally given. The interest rates on deposits are at present fixed by this bank cartel. On sight deposits 1 per cent is paid and on the longest term deposits up to 5 per cent. Advances cost $10\frac{1}{2}$ per cent and discounts of commercial bills $7\frac{1}{2}$ -10 per cent.

Because, however, business concerns as well as the public authorities must keep a certain amount of funds readily available without regard to the rate of interest, the market for short-term capital is much better supplied than that for long-term capital. Total bank deposits in the middle of 1951 (not counting DM 4,000 millions of savings deposits) amounted to approximately DM 19,000 millions. Of these DM 6,000 millions belonged to the public authorities and DM 13,000 millions to private depositors, chiefly business firms. After May 1950, private deposits rose in one year by DM 2,200 millions, or that is, in exactly the same proportion as the index of production (28 per cent). In view of the international rise of prices, this means a relative decrease. The other side of the balance sheet, i.e. short-term credits to the economy, has shown the same rate of increase. It is, however, remarkable that over the same period time-deposits increased by DM 1,500 millions, that is by 100 per cent, while at the same time one-third of all the long-term securities issued remained unsold.

The market for short-term capital rests on a very well organised, extensive banking apparatus which is intimately connected with

business concerns of all sizes. This market thus has a double advantage over the long-term capital market, which possesses neither the funds nor a banking apparatus in any way corresponding to the great importance of long-term industrial credit. The total of long-term credits given by banks to industry, commerce and handicrafts, amounted, in the middle of 1951, to approximately DM 4,000 millions, or, that is, to less than one third of the short-term credits. The lack of a suitable organisation for long-term credit, an organisation which is accessible to all and not merely to the biggest concerns, is a serious problem for a number of reasons. First, because given the shortage of capital in Western Germany, the importance of credit is much greater than formerly, and this is especially true of long-term credit which alone makes possible a secure financing of plant and equipment; secondly, because the insufficiency of long-term credit means that a good deal of financing is short-term which would better be long-term, and this increases the sensitiveness of Germany to the trade cycle; and finally, because in what there is of an organisation for long-term credit, the state, with one powerful bank, the «Kreditanstalt für Wiederaufbau» (Reconstruction Finance Corporation) already possesses the lion's share. It looks as though the state intended to reserve this largest and most important field to itself and indeed with remarkable means. At the present moment (autumn of 1951) a government bill is being presented according to which a part of the sums annually set aside for depreciation in the manufacturing industries, independently of whether they are making profits or losses, is to be forcibly diverted to the financing of the raw material industries, especially the controlled and lagging coal industry. The extremely powerful Trade Unions have already demanded that 100 per cent of

the depreciation allowances shall be forcibly taken away and redistributed by the Reconstruction Finance Corporation — a programme which would imply complete socialisation and the end of the Market Economy.

Briefly, the capital sector of Western Germany since the reform of 1948 may be characterised as follows: forced saving through the levelling of net incomes; the concentration of capital formation partly in the hands of the State with rigid central distribution, and partly — the larger part — in the hands of business concerns as the result of numerous measures of state policy; direct long-term investment in those concerns which are creating capital; and in consequence the destruction of the free capital market. This is a policy which is highly unfriendly towards the private capitalist, is relatively friendly towards management, and clearly shows the beginnings of a central direction of investment.

IV

Western Germany has since the end of the Second World War been confronted with the necessity of solving two major economic problems: the development of exports, and capital formation. Since the reform of the economic order undertaken from the middle of 1948 on it has made good progress in both these directions. The first problem was solved with remarkable success through the mechanism of the market economy; the second was approached with methods which suppressed the free market. Thus Western Germany does not have a free market economy but something half-way towards such an economy; and this half-way position is not liberal, and is not intended to be. What it is intended to be is a social market economy, and what it is in danger of becoming is a centrally directed economy.