Post-War German Finances

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POST-WAR GERMAN FINANCES[1]

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THE system of financing both the preparations for war and the war itself which Hitler adopted appears superficially to have been highly successful. Indeed it happens that the policy of rearmament before the war fitted Germany's economic position very well and did much to pull the country out of the depression into which it had fallen after the First World War. Nevertheless, the strain of war finance told heavily upon the German economy during the war. An actual financial collapse was averted only by the windfall of resources plundered from occupied territories, and the whole financial structure was becoming exceedingly difficult to manage in the early part of 1945. At the time of defeat the note circulation and the volume of bank deposits were rapidly increasing, and various devices were being adopted to keep the supply of the necessities of life flowing in the right direction. Barter shops were permitted, and even before the Allied occupation some of the more important elements of German economic life were by-passing the normal mechanism of money.

Thus it was that the victorious Powers found a Germany in which the means of payment were at least ten times the amount appropriate to the national income and to the level of production. The currency note circulation rose from five billion Reichsmarks in 1935 to fifty billion Reichsmarks in 1945, a ten-fold increase; bank deposits rose from thirty billion to one hundred and fifty billion, a five-fold increase, and the Reich debt (excluding war damage and other claims) rose from fifteen billion to four hundred billion, a twenty-seven-fold increase. Wage and price levels had been maintained substantially unchanged during the period of ten years up to 1945 and were, in many instances, very artificial. Real wealth during the war declined by about one-third, and as the immediate productive capacity was reduced by about half, it is abundantly clear that the means of payment vastly exceeded the requirements. Conversely, the wage and price levels were far too low in relation to the volume of purchasing power, having been kept in a most rigid strait-jacket. It was the fate of the Allied armies to arrive just at the time when German finances were reaching breaking point.

There is no doubt that up to that point the stimulus of successive victories, and the plunder of resources from occupied territories, did much to allay any feeling of mistrust in the large and growing volume of money in circulation. In a sense, therefore, the willingness of German people to hold unused bank balances or short period Government debt—their liquidity preference—was artificially and temporarily increased so that the excessive volume of money

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did not break the rigid price and wage controls which were being enforced so successfully. There was always the belief that with ultimate victory the large volume of savings which were being drawn relentlessly into the Government coffers could be spent upon real goods.

Defeat brought disillusionment, and confidence in the Reichsmark collapsed rapidly. People realized that there were no goods to match their inflated money balances, and that there never would be these goods in the necessary volume.

The defeat of Germany in 1945 was, in the financial sphere as in so many other spheres, much more far-reaching than the defeat in 1918. In 1918 a German Government was left intact which could deal with the victorious Powers, could bargain on such matters as reparations, and could control the ordinary machinery of government. In May 1945 the German Government disintegrated. The Finance Department disappeared, and so did the Reichsbank. The officials fled to all parts of Germany, but mainly to the west and to the south. There was thus no central collection of revenues, no control of expenditure, no budget and, indeed, no Government.

Plans for the control of German finances, in so far as they were based upon an existing financial machine, were obsolete even before the details were worked out. Plans made on the assumption that there might be no central German government included the setting up of a central finance department, as this was recognized as essential to the proper government of the country. Unhappily, the four Occupying Powers failed to agree upon the implementation of the proposals made at Potsdam, and a central German finance department was never set up, and even today (April 1948) there is no central control of German finances, and no co-ordination of financial policy throughout Germany.

It will be explained later that, except in the field of taxation principles and the control of expenditure, the Allied Control Authority in Berlin failed to agree upon the essential financial measures for the control of Germany as a single economic unit, and failed also to agree upon common measures to be implemented independently in the four zones.

Before the end of the war, the three Governments of the United States, the U.S.S.R. and Great Britain, had agreed upon the issue of Allied Military Marks to circulate at par with the Reichsmark, and to be available to the military authorities for the purchase of supplies requisitioned in Germany, and for the payment of troops in so far as it was deemed reasonable to allow the troops to spend their pay in Germany. Arbitrary rates of exchange were fixed for determining how much should be paid to troops, and for the Western Powers the rates were £1 = 40 Marks = $4.00. No arrangement or agreement had been entered into to determine what the total volume of Allied Military Marks to be issued should be or in what proportion they should be issued by the three (subsequently four) Occupying Powers. In practice each of the four Powers requisitioned whatever it required in Germany and put no limit upon the Allied Military Marks which it paid out.

In fact, during the first two years, the British issued 1,800 million Allied Military Marks, the Americans 1,200 million, and the French 600 million. The Soviet authorities, having undertaken to furnish particulars of the number of Allied Military Marks issued, failed to give the figure, and this has been estimated at between 6,000 and 8,000 millions. These figures are sufficient to show that, by comparison with the 42,000 millions increase in note circulation, and the still greater increase in bank deposits up to May 1945, the issue of Allied Military Marks was not a dominating factor. There was, of course, no issue whatever of Reichsmarks after May 1945 because there was no Government or other issuing authority.

Perhaps the most surprising thing during the first two years of occupation was the success, if it may be so described, of the wage and price control system. Notwithstanding the collapse of all hope that a large volume of goods would be coming forward upon which the money could be spent, and notwithstanding the increase in note circulation, prices and wages were maintained substantially at the level at which they were fixed ten years earlier. There were a few exceptions, but during the whole of the first two years price and wage indices moved up only a few points.

Several factors contributed to this remarkable result. The first was the extraordinarily efficient price control mechanism which operated on a very decentralized basis; when much else in Germany had collapsed the price and wage controls functioned. Secondly, the whole population had become so accustomed to these rigid controls that through sheer inertia there was no great attempt to break them.

But the success of price and wage control in Germany was an utterly hollow victory. The rot which had entered into the trading system before defeat in May 1945 grew with great rapidity afterwards. It was some time before black markets, as understood in France and other countries occupied by Germany, developed on a large scale in Germany itself. Barter trading, which had been recognized by the German Government prior to May 1945, was also recognized by the Occupying Authorities after that date. Barter, however, became far more widespread than the governmental authorities intended and began to supersede the normal forms of trade. It is not difficult to see why and how this came about.

A farmer would want shoes for his children; the shoemaker, with a little leather or ersatz material available, would want food for himself and his family. But the infinitesimal production of shoes was insufficient to provide each person in Germany with more than one pair of shoes a year for every hundred pair of feet. On the other hand the rations were desperately short, and under-nourishment was the general rule. What more natural thing, therefore, than that the people with the goods which were in such keen demand should get together and exchange these vital commodities, instead of giving them up under the ordinary market arrangements for money (at fixed and very low prices) when it was perfectly clear that this money would not buy what they were so urgently needing?

It is easy in a country where the shortage of necessary goods is relatively small, to condemn barter transactions of this kind, but in Germany the moral issues are today by no means so clear cut. Faced with conditions of starvation, or near starvation, for their families, men will take action which may be outside the letter of the law, but can hardly be said to be morally reprehensible.

Another feature of the flight from money in Germany was the use of cigarettes, imported by the occupying troops. British and American troops in particular were supplied with large quantities of cigarettes on terms which were very favourable. In so far as the cigarettes were not, in fact, smoked by the persons to whom they were issued—and the armies contain many non-smokers, both men and women—and in so far as extra supplies could be extracted from home, these cigarettes were available to be bartered for goods or services from Germans. It is true that this bartering was against regulations in the case of British troops, but the regulations were, in practice, impossible to enforce. One cigarette in Berlin was worth seven or eight Marks, and in practice many little services, such as the repair of shoes, or of a tennis racquet, could be effected only by giving up two or three cigarettes.

This use of cigarettes was perhaps less reprehensible than the actual sale of cigarettes for Marks, as the latter practice became the regular method for what was one of the greatest frauds upon the British and American exchequers. A packet of twenty cigarettes could, because of the shortage of tobacco in Germany, be sold for 160 or more Marks, which the soldier could spend in his mess or canteen, either to buy drinks or to buy further cigarettes. For 160 Marks the soldier could get £4 worth of goods from his canteen, and a mere 1s. or 2s. would be sufficient for the repurchase from the canteen of the packet of cigarettes which he had sold on the black market. He could even remit part of the £4 to be paid in sterling to his family at home, or draw out this money in sterling and smuggle it back to Britain. The same fraud on an even more extensive scale was practised by American soldiers, and the net loss to the British exchequer has been estimated at £41 million, while the corresponding figure for the United States Zone was $224 million.

The worst features of the cigarette racket were eliminated by the introduction of a special British Army Forces voucher for use in canteens, and by similar arrangements in both the American and French Forces, but the use of cigarettes as the means of purchasing goods and services from Germans remains.

It is easy after the event to point out the delays which occurred in remedying a deplorable leakage, but during the war when the scheme for issuing Allied Military Marks was agreed upon nobody foresaw the extent to which the real value of Marks in terms of cigarettes would fall, or the ease with which the triangular trade cigarettes—Marks—Sterling would operate. Once the trouble was discovered a remedy had to be devised which did not take away genuine conversion rights given to every soldier in the Occupation Forces. And, of course, the designing and printing of new "vouchers" for use in lieu of Military Marks could not be completed overnight. The system of Forces Vouchers introduced in the American and French Zones followed the lines of that devised for the British Zone.

That a reform of the German currency is necessary, and is urgent, has been clear to the Occupying Powers for a long time. Unfortunately the terms upon which such a conversion should be carried out have not yet been agreed. Until such reform takes place there is little or no hope of any recovery in the German economic machinery of production and distribution of essential goods.

How vicious is a system, in which prices and wages are kept fixed but in which there is an excess of purchasing power, and how bad is its effect upon production, can be illustrated by the conditions of Western Germany today. A loaf of bread at the fixed price costs 80 pfenning; on the black market it is worth 80 Marks—i.e., one hundred times the fixed price. The same kind of difference between fixed and black market prices rules for most essential commodities. The task, therefore, of food collecting authorities is an almost impossible one; so long as there is a chance of securing fuel, clothing, or something else which he needs, the farmer will do his utmost to avoid parting with his valuable food for money which can buy practically nothing.

Unfortunately this is only one side of the picture. The miner has found only too often that a hard week's work in the mines has resulted in a wage packet which is worth less than a packet of cigarettes. If he can scratch together one or two things which he knows he can exchange for food, it is better for him to work just two or three days only (to qualify for a heavy worker's ration) and to spend the rest of the week hawking round his odds and ends in the countryside for extra food. The same is true of dock workers, transport workers, steel workers and, indeed, of the whole working population.

It is true that for the miners in the Ruhr, arrangements have been made to provide them with so-called "incentive" goods, so that a miner is in a privileged position for certain quantities of food, drink, tobacco, soap, etc. But in so far as the trickle of essential goods is diverted in greater volume to one part of the population, less is available for the remainder. Indeed an exceedingly high proportion of the trickle of imports of essential goods, other than food, has gone to miners under the "incentive" scheme. To attempt to apply the same scheme to other essential workers would be to invite complete failure, because the volume of goods is not sufficient for this purpose.

In any event we are confronted with a paradox that a Government which is striving hard to prevent the growth of the black market and to bolster up the Reichsmark, is itself admitting that payment in money is ineffective. The Government itself is prepared to barter these "incentive" goods for work on coal production. That itself is one measure of a lack of confidence in the currency.

There is another aspect of the system of maintaining fixed wages and prices which may escape attention. With low levels of production, and with the special difficulties arising from the devastation of war, and the failure to maintain essential equipment, costs of production have risen enormously. This means that the production of some of the most necessary commodities is unprofitable. Until April 1948, coal continued to be sold at about 15 Marks a ton, although the costs of production are double this figure, or even more. The coal mines are no longer in private ownership, and, indeed, had they been, the private owners would long since have become bankrupt. The losses on coal fall on the budget. But for other commodities the stop on prices, at a time when costs have risen because of uneconomic methods and scale of production, has been a great discouragement to enterprise. If it requires a good deal of moral strength to go on producing to make profits in Marks, which are worth so little, superhuman (or sub-human) qualities are required to continue to produce with the certainty of making heavy losses, so that the whole real capital of the enterprise is frittered away.

In a highly developed industrial system, barter can never be a substitute for money. A large corporation cannot receive payment other than in money, and cannot, except to a very limited degree, pay in kind for its labour or raw materials. The vital need to retain a healthy and free relationship between the purchasing power of money and real goods becomes apparent when the true purchasing power disappears as in post-war Germany.

To go into the effect of the internal financial disorder upon Germany's foreign trade would carry us too far from our main subject, but it is to be observed that internal prices had become so artificial that any rate of exchange fixed for one purpose or for one set of commodities would have been quite inappropriate for another purpose, or for another set of commodities. In fact, although a rate of 40 Marks to the £ (or 10 Marks to the dollar) was fixed for purely military purposes such as the pay of troops, no rate of exchange was fixed, and no attempt has been made to relate internal and external prices by the use of a uniform rate. For example, the price obtained for coal exported in terms of dollars bears no relationship to either the internal price of coal in Marks, or to the cost of production. Until there is a settlement of the internal financial position, no satisfactory rate of exchange can be fixed, and a sound basis for transactions will not exist.

The need, therefore, for a satisfactory money in Germany is a vital one. Until money is restored in a healthy form to the German economy, production will remain at its present low level.

If we turn our attention to the actual volume of Marks in existence, we can discover one or two factors which indicate that in a tantalizing fashion a solution of the problem has been within reach for a long time. In the first place, quadripartite government in Germany was not wholly unsuccessful in the sphere of finance. Looking back at the long list of failures in Berlin, the success achieved within the first few months on governmental finances stands out almost alone.

Within the first few months agreement was reached on the principle that at all levels of government the amount of the expenditure must be limited to the amount of revenue obtainable. Agreement was also reached upon all questions of taxation, both direct and indirect, and, as from January 1, 1946, taxes were increased to levels which were comparable with those which were imposed in Britain and America during the war. The implementation of the laws increasing the taxes was not uniform in the different zones, but on the whole it was effective in all four zones.

In the British Zone steps were taken to set up a Finance Headquarters in Hamburg which controlled that part of the Reich budget which was applicable to the British Zone. The *Länder* Governments were made responsible for the collection of Reich revenues and for the payment of Reich expenditures, and were required to keep separate accounts. Occupation costs were put on the Reich budget, and a system of scrutinizing all requisitions by military authorities was instituted to prevent waste and abuse. The budgets of the *Länder* Governments themselves, and of the lower levels of local government were also scrutinized, and all unnecessary expenditure ruthlessly cut out. As a result, in the British Zone a state of affairs was reached within eighteen months in which every local government was financing the whole of its revenue out of taxation, and the central budget for the zone was very nearly balanced.

In the British Zone there were two other factors which had a deflationary effect. First, there was the receipt of Marks in exchange for sterling and sterling goods, which had cost the British taxpayer £41 million. Of these Marks nearly 1,000 millions were left in the hands of Army paymasters, and to that extent the British Exchequer made a substantial contribution in cutting down the active note circulation in the British Zone. The second factor was the excess of imports over exports which resulted in the receipt by the zonal finance office of more Marks for the sale to Germans of imported food, etc., than the Marks paid out to Germans for goods for export. Again, in so far as the British Government paid out more sterling and dollars for these imports, than the sterling and dollars received for the exports, its action had the effect of withdrawing Marks from public circulation and putting them into the coffers of the zonal financial authorities. The deflationary effect of an excess of imports over exports is worth special note; but it should also be noted that if the Marks so received had been treated as budget receipts and spent accordingly the natural deflationary effect would have been neutralized.

As a consequence of these measures, within eighteen months of the Occupation the note circulation in the British Zone was down to a point lower than it was at the date of the surrender in 1945, and there were, in fact, withdrawn from circulation Marks equivalent in value to that of Allied Military Marks put into circulation in the British Zone.

The methods adopted in the American Zone, and in the French, were different from those adopted in the British Zone. In general a much more decentralized administration was introduced and more power was given to the *Länder* Governments. It is probably true to say that, in general, the control was looser, and, as a consequence, the check on expenditure was less effective than in the British Zone. Nevertheless, real progress towards balancing budgets was made in both zones.

The position in the Soviet Zone was substantially different. The payment to soldiers in that zone was wholly in Marks, and the Soviet armies lived on the land to a much greater extent than did the armies of the Western Powers. On the other hand the Soviet authorities took much more drastic action with regard to banks and bank deposits. Whereas in the British, American, and French Zones the authorities had been content to block the balances of Nazi institutions and leading Nazi persons and criminals, in the Soviet Zone *all* bank deposits were blocked, and all banks were closed. There was a subsequent reopening of savings and other banks on a municipalized basis, but the amount of purchasing power made available through normal banking channels to the German public was much smaller than was available in this way in the Western Zone. On the other hand, there is no doubt that Soviet Occupation costs, including pay of troops, have been much greater than the corresponding costs in the other three zones. But on balance it is probable that the sum total of means of payment, including bank deposits, in the Soviet Zone was actually reduced. The Soviet policy has been thus to reduce the amount of purchasing power available to Germans and German Governmental authorities at the expense of the amount of purchasing power available to Soviet Governmental, and military, authorities in the zone. In this way their grip on the German economy in the Eastern Zone has become much tighter than has been the grip of the Western Powers on the German economy in the Western Zones.

It was a matter of regret that, having agreed so much in the financial sphere, the quadripartite machinery of government in Berlin has so far failed to agree upon (a) the setting up of central financial machinery to control these matters on a common basis for the whole of Germany and (b) currency reform.

The history of the attempts to agree upon financial measures for the whole of Germany reveals that there was nothing particularly wrong with the form of quadripartite government in Germany, so long as it had to handle matters in which no big political issue was involved. Thus, agreement upon taxing Germans, and upon controlling their expenditure, though a vast and complex subject, was successfully achieved; agreement on a central financial department, and upon currency reform was not achieved, because it involved the whole question of the future form of government in Germany and the manner in which that government was to be controlled.

On financial reform the American delegation tabled a plan known as the Dodge Plan; a detailed British plan was in existence before the Dodge Plan was tabled. The Dodge Plan has received considerable publicity, although, in the first instance, it was intended to keep the matter secret. The main elements in the plan were as follows:

(a) The currency was to be converted by the issue of one Deutschmark for every ten Reichsmarks (or Allied Military Marks). The conversion would apply not only to currency notes, but to all bank deposits and all private debts, mortgages and other money obligations, including local government obligations.
(b) The Reich debt and the debts due from the old Reich Government were to be invalidated, but as this would automatically bankrupt all banks, insurance companies and other financial corporations, which had the greater part of their assets in the form of Reich securities, these institutions were to be issued with a sufficient amount of a new Governmental debt, to be charged upon the whole of Germany, as would enable them to remain solvent.
(c) Prices, wages, salaries, rents and taxes were, as from the date of conversion, to be paid in the same amounts in Deutschmarks as they would have been paid in Reichsmarks. This was subject to a few minor price variations only. The effect of the conversion would thus be much the same as an over-night ten-fold increase in prices, wages, salaries, etc. Or, to put it the other way round, all existing balances of money would be reduced to one-tenth of their previous volume in terms of purchasing power.
(d) A 50 per cent mortgage would be raised on all physical assets exceeding 1,000 Reichsmarks, including real estate, plant, stocks, etc.
(e) A capital levy would be charged on all net wealth, after charging the fixed 50 per cent mortgage.
(f) The proceeds of the mortgage and of the capital levy would be vested in a War Losses Equalization Fund to be administered for the whole of Germany.
(g) Claims against the old German Government in respect of war damages, old contracts, war losses and other claims admitted by the controlling authorities, would be satisfied by bonds charged upon the War Losses Equalization Fund. These bonds would be non-interest bearing, and the date of redemption would be left undetermined until such time as it became clear that the Fund could meet the bonds, and the German economy could stand the effect of meeting the claims.
(h) Agreement would be reached between the four Occupying Powers upon the amount of Occupation costs which each of them would incur in Germany.
(i) A Central Bank, or other institution, would be set up to administer the new currency, and the War Losses Equalization Fund.
(j) The conversion would come into operation in the autumn of 1946.
(k) A rate of exchange between the Mark and the £ was to be fixed at approximately 16 DM = £1 = $4.00.

Germany's plight is such that hardship for several years is inevitable and, therefore, any scheme of financial reform is easy to criticize, since it is bound to bear more harshly upon some parts of the community than upon others.

While discussions proceed in Berlin it would be unhelpful to criticize the Dodge Plan in detail.[1] Its general weakness is that it seeks a standard of equity between different classes of the German people which is unattainable as practical politics at the present time. The reason for linking a capital levy with currency reform is that currency balances are widely distributed, whereas real property tends to be in fewer hands. A cutting down, therefore, of the value of purchasing power in the hands of those whose assets consist mainly of money, and claims upon money, while leaving the real property owner untouched, would be inequitable. Again, it may well be that somebody entitled to war damage compensation under the old German law is a deserving person, and it would be unfair to pay him no compensation while leaving the man whose property is unscathed with no share of the vast burdens of war damage, which is concentrated mainly upon the big towns.

Differences and difficulties can be discussed for a long time, but currency reform is urgent and, indeed, vital to the whole German economy. On the other hand, while equity in property rights is, on a long view, exceedingly important, it is impracticable to hold up an urgent reform of currency until equity can be achieved by such complicated measures as a comprehensive mortgage upon property, and an ambitious capital levy.

As the published reports have shown, the earlier discussions on currency reform broke down on the question of the place for printing the currency. The Soviet delegation desired part of the printing in Leipzig, whereas the other delegations preferred the printing of the whole issue in Berlin. It would be wrong to assume that a technicality of this kind was all that separated the representatives of the four Occupying Powers. Behind the disagreement on the technicality lay fundamental differences in objectives.

Instead of arguing the case for one point of view or another, however, it would be more useful, for our present purpose, to consider the factors which would have to be taken into account in arriving at any final settlement.

Underlying all discussions on Germany, there is the conflict between the objective of security, i.e., the prevention of the resurgence of Germany as a menace to peace, and the objective of restoring German economy on a peaceful basis to the state in which it can make its vital contribution to the economic revival of Europe as a whole. In so far as there is the fear that one or other of the Occupying Powers might dominate Germany, and use its resources as an offensive weapon, there is this further factor to be reckoned with in the struggle to remove suspicion between those Powers.

On security grounds there are powerful arguments for the complete decentralization of the whole German economy. Germany was controlled from Berlin, and the purposes to which the vast industrial resources of the Ruhr were put were determined by a powerful central Government in Berlin.

The separate German states are, taken individually, far less able to wage

[1]At the time of writing (April 1948) quadripartite meetings have been suspended, but currency reform remains on the agenda to be taken up when the meetings are resumed.

war and have far less interest in so doing. Decentralization in an extreme form is thus advocated on security grounds, and appeals most naturally to the French.

Decentralization of political powers would be ineffective unless it applied also to certain large aspects of financial control. Hence the desire to break up the control of German finances by the old Ministry of Finance and the Reichsbank. The big banks in Germany, the Deutsche, Dresdner and Commerz, were also highly centralized.

It is not unnatural that the formalization of the rights of individuals, specifically written into the American Constitution, should suggest to our American colleagues a similar federal form of government for Germany. This brings with it the corollary of a decentralized banking system on the American plan with each *Land* having its own central bank; the central banks in turn being linked by a federal banking board, or some similar institution, for the whole of Germany.

Power to issue notes, and, what is as important, power to control credit policy, is, in a modern economy, one of the most powerful instruments of government. By the issue of notes, or of credit, resources can be directed according to the policy of the government controlling the note issue or the credit system.

It is, therefore, not unnatural that the advocates of decentralization should also advocate decentralization of financial powers, even to the point of advocating the separate right of issuing notes in each *Land* in Germany.

On the other side of the picture, we see the efforts necessary to restore health to the German economy. If anything is abundantly clear in an economy which has been devastated by war, it is that restoration can only become effective if strong financial control is exercised, and indeed, such strong financial control can only be exercised centrally so long as there is a single currency.

It is easy to be misled by conditions in the nineteenth century in Europe when a gold standard, and the use of gold as a currency, made governmental financial policy a relatively unimportant factor in the economic conditions of a country as a whole. One can also be misled by conditions in the United States where a gold standard functions, and where the whole economy is prosperous, and each part of the whole area can be relied upon to maintain a balance with the rest of the area.

The dangers of attempting to agree on a single currency for the whole of Germany, without placing under a single authority the power to control both the note circulation and the credit policy which gives rise to the need for the notes, are abundantly clear. If the credit policy in each *Land* were left to the *Land* Government, and if the amount of notes to be issued within that *Land* depended upon that policy, there would be an irresistible tendency to inflate the currency. Each *Land* would have a direct interest in expanding that proportion of the whole note circulation which is issued within its borders, because by issuing a larger quantity of notes, each *Land* is able to suck towards itself a greater proportion of the whole country's current production.

Agreement has been reached recently upon the decentralization of the banking system in the British and American Zones, with a central bank for each *Land*. For the combined zone there is to be set up a *Bank Deutscher Länder,* a kind of super-banking board, and the extent to which the natural inflationary tendencies are kept in check will depend upon the effectiveness of the power of this central institution over the credit policy of the *Länder Central Banks* and of the *Länder* themselves.

This danger of inflation by decentralization remains whether we consider the issue of single currency for the whole of Germany, but with separate issuing powers in each of the four zones, or the issue of the same currency with separate issuing powers in each *Land,* of which there are three or four in each zone. So long as the financial policy of the four Occupying Powers in Germany remains unco-ordinated, there remains the fear that too great a proportion of the resources of the country will be sucked towards the zone which issues the largest amount of currency. Precisely the same is true if, with a single currency note issue, the credit controlling powers are left decentralized.

Strong central financial powers are, however, consistent only with a strong central government, with a clearly defined policy. There is no such single government in Germany at the present time, and, therefore, the basis for a centrally controlled currency issue does not at present exist.

The alternatives which are open to the controlling authorities at the present time are, therefore, (a) a single currency for the whole of Germany with adequate central control of that currency, which means an adequate central government, or (b) separate currencies for each area within Germany for which a consistent policy can be followed.

The need for decision in Germany is very great indeed. It has been shown that the revival of economy is impossible without financial reform. At the present time, when financial reform has been discussed throughout Germany, the very knowledge that reform of the currency is pending, and that the currency may be devalued, is itself a further factor tending towards stagnation, and towards loss of faith in the existing currency.

Vital and urgent as is a decision on this question, nothing could be worse for Germany than that a fundamentally wrong decision should be taken. A decision to issue a single currency for the whole of Germany without securing a centralized and powerful control of the note issue, would spell disaster and disillusionment when the inevitable inflation developed, and would make a reform of the currency on a sound basis more difficult than ever.

A possible alternative would be the issue of a separate new currency for each of two or more areas within Germany, the currency for each area being distinctive, so that the area of issue could be identified easily even though the nomenclature and denominations of the notes might be the same for the whole country. If this were done simultaneously in all zones, and a uniform credit policy followed in all zones, the notes of one area would circulate approximately at par with the notes of another area. No area could inflate at the expense of another area, so long as the exchange rates between the notes were allowed to fluctuate, since the effect would be to depreciate the notes of that area in terms of the notes of other areas. This would mean, in effect, separate currencies, and virtually the division of Germany into separate States, each of which would be free to choose its own internal financial policy. Uniformity of credit policy could not be enforced; it could only be an objective. Customs barriers between these States would be inevitable until the internal policies of the separate States were so co-ordinated that the exchange rates between the separate currencies, though free to fluctuate, remained constant. Such a plan would make it possible to amalgamate the issues into a single currency for the whole of Germany as and when proper central government, with adequate financial powers, can be set up for the whole country.

April 1948.