The Second German Inflation and Destruction of the Mark

(1933 - 1948)

The United States — 1970 until ?

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ABOUT THE AUTHOR

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(1933 - 1948)

The Great Depression in Germany provided a fertile soil for the tragic events that were to follow. Under the influence of certain social and economic ideologies, the governments of all Western countries were busily restricting world trade and commerce, and strenuously raising taxes in order to maintain public expenditures. Between 1930 and 1932 the German President issued five emergency orders (Notverordnungen) that imposed drastic increases in tax burdens. Old taxes were raised, exemptions abolished, and new taxes piled on old levies. The percentage of public revenue to national income, which in 1928 exceeded 35 percent, rose to 53 percent in 1932.[1] The disintegration of world trade and finance, the disarrangements and maladjustments caused by previous policies, together with such drastic increases in fiscal burden, bore their bitter fruits.

Economic historians are aware of the startling similarity of the economic policies of the Hoover Administration in the U.S. to those conducted by the Brüning Administration in Germany. Both sprang from similar economic ideologies and yielded nearly identical effects. Today, nearly half a century later, most historians in both countries offer identical explanations. Mainstream economics, which is reviewing and rewriting economic history through Keynesian glasses, lays the blame for the economic disaster on the **deflationary policies** of both administrations. But mainstream literature, so critical of the Brüning policies of 1930 to 1932, is enthralled and enthusiastic about the full-employment policies that characterized the period from 1933 to 1936. We should like to mention in passing that the German director of those contracyclical policies was Adolf Hitler. The manager was Hjalmar H. G. Schacht whom Hitler reappointed president of the Reichsbank in 1933 and installed as minister of the national economy in 1934. The intellectual architects were eminent economists, such as W. Lautenbach, H. Dräger, W. Grotkopp, R. Friedländer-Prechtl, H. Fick and F. Bischoff. It is unlikely that they were influenced by John Maynard Keynes. But it is a titillating question how these writers and the German revival aided Lord Keynes in his "long struggle of escape" from orthodox economics, of which he reported so eloquently in 1936 in his *General Theory of Employment, Interest and Money*.

I Full Employment Policy (1933 - 1936)

In just four years unemployment in Germany declined from 5.6 million in 1932, or 31 percent of the working population, to 1.6 million in 1936, or 8.5 percent. The number of gainfully employed rose from 12.5 million to 17.1 million. The index of industrial production, which is a significant yardstick for economic activity, rose from 58.7 in 1932 to 106.7 in 1936. (1928=100)

This remarkable revival of economic activity was achieved by an ingenious combination of dictatorial methods that greatly lowered the real costs of labor and otherwise reduced business costs. While the previous administrations had significantly raised their tax burdens, in order to maintain the government apparatus, the new administration successfully shifted this burden to labor income. Immediately, upon assumption of Nazi power in 1933, all labor unions and associations were summarily abolished. A labor trustee (Treuhänder der Arbeit) assumed power over all collective bargaining and henceforth kept practically all wage rates and fringe benefits at given depression levels. Similarly, all employer contributions to social security and other labor funds were frozen or even lowered throughout this period. By force and many other insidious devices to achieve "voluntary" cooperation, the government successfully lowered production costs. This reduction in costs then helped to maintain goods prices despite the deficit spending and currency creation that began in 1933.

The adoption of expansionary credit policies was a gradual process that was hidden in a maze of devious devices. The Reichsbank was prohibited by law from financing government deficits. But it was possible to create and extend credit by special financial institutions, public and private, that were organized for the purpose of circumventing the legal restrictions. Their bills of credit could be freely accepted and discounted by the central bank. Furthermore, these credits and the expenditures they financed enjoyed the advantage that they did not appear in the government budgets and could be used to hide armament spending. In 1933 and 1934 some 4.6 billion marks were thus emitted, an amount which nearly equalled total tax revenues for the Reich in 1933. In 1935 and 1936 it exceeded 8 billion marks.[2]

The government thus created "financial intermediaries" whose acceptances could be discounted by commercial banks as well as the Reichsbank. In particular, it organized the Public Works Corporation (Deutsche Gesellschaft für öffentliche Arbeiten), which specialized in public housing. The Construction and Soil Bank (Deutsche Bau-und Bodenbank) invested in private housing. The Rent and Settlement Bank (Deutsche Rentenbank-Kreditanstalt und Siedlungsbank) extended agricultural credits. And the Transportation Bank (Deutsche Verkehrs-Kredit-Bank) financed transportation investments. A businessman who received a government order would draw a draft on one of these "banks" ordering it, in 90 days, to pay to the order of a person a designated sum of money. The bank would accept the draft which made it eligible for immediate sale in the open market or to the Reichsbank. Or the bank would have its own bills accepted by other institutions in order to finance the project directly. The Reich government guaranteed it all, promising to repay all bills and acceptances between 1934 and 1938. Long-term financing was then to be made available from government revenues, or the capital market, or repayment by the beneficiaries, e.g. of a loan.

Together with this monetary expansion through short-term instruments came tax reductions that aimed at inducing a revival. The high rates imposed by the Brüning Administration were retained except for those levies a reduction of which would hopefully stimulate employment. Treasury Assistant Secretary for Tax Policy, F. Reinhardt, spearheaded the following reform:

1. As of March 31, 1933, all newly licensed motor vehicles were exempted from taxation. The owners of old vehicles were given the choice of meeting all future registration fees and levies with a lump-sum payment. This measure was eminently successful in stimulating automobile production.

2. All capital replacement expenditures were made fully depreciable during the year they were made. In an economy that evidenced symptoms of "overcapacity" and therefore lacked proper capital replacements, a special stimulation of the capital goods industry seemed to be in order. Also this particular reduction in income taxation proved to be highly successful.

3. A ten percent income-tax credit was granted for renovations and expansions of buildings.

4. All pre-1933 over-due income tax liabilities were cancelled provided the amount due was invested in renovations, expansions and replacements.

5. Households employing domestic servants received additional income-tax exemptions for dependents. This measure, which openly aimed at employment rather than redistribution, also had its desired effects.

6. In order to induce some three million women to leave the labor market of six million, loans of 500 to 800 marks were granted upon the establishment of new households. The loans were interest-free and repayable in monthly installments of one percent. Every birth of a child then cancelled one-fourth of the loan. To raise the revenue for this measure higher tax rates were imposed on bachelors.

7. Various other tax rates were lowered to benefit farmers, home owners, and wholesalers. Employer levies in support of the unemployment compensation fund were reduced as unemployment declined.[3]

This tax reform, together with the credit expansion mentioned above, produced its foreseen effects. Since it lowered business costs, especially in favored industries, it raised the marginal productivity of labor and thereby stimulated the demand for labor. Hitler recognized the importance of full employment for the victory of his party and the foundation of his dictatorial regime. His "labor battle," as he called the program, met with the enthusiastic approval of most people.

II Financial Policy During Full Employment (1936 - 1939)

At the end of 1936 German unemployment had fallen below the one million mark, which in those baneful years of world-wide depression meant full employment. As production expanded while wage rates were frozen the unit cost of production declined substantially, boosting profits significantly. But goods prices began to rise, which prompted the administration in 1936 to impose comprehensive price controls. By 1939, at the beginning of the war, prices had risen merely 9 percent in six years, which in modern terminology would be called a remarkable stability. Of course, the German economy was no longer a market system, but a command order organized for war.

During this so-called "full-employment phase" labor income is estimated to have risen some 70 percent. 18 percent of this improvement is ascribed primarily to longer working hours raising average income. 52 percent must be attributed to the expansion of employment.[(4)] The freeze of wage rates surprisingly did not generate popular dissatisfaction or create political problems. After so many years of unemployment or underemployment, the population was happy about the opportunity to work and grateful for the job security.

In 1936 the soaring profits led to the only prewar tax boost. The corporate income tax which heretofore claimed 20 percent of business income was raised to 25 percent in 1936 and 30 percent in 1937. Revenue from this tax alone quadrupled in four years (from 593 million marks in 1935 to 2.417 billion marks in 1938), which indicates the remarkable rise in corporate profits.

Symptoms of excess demand made their first appearance in 1937. Shortages developed in a number of consumers goods, especially in meats and dairy products. Long waiting lists appeared for many items of housing construction, and for tools and dies that were needed in the armament industries. The inexorable laws of the market, officially outlawed by an omnipotent regime, were revealing their effects to anyone able and willing to see while the government moved ahead on the highways and byways of the command order. It introduced a comprehensive rationing system that allocated essential goods and services according to national-socialistic concepts of merit and adequacy. The distribution of important foods was organized by way of "customer lists," that is, consumers were requested to register with a grocer for goods allocation and redemption of ration cards and coupons. The sale of important raw materials as well as construction materials and tools and dies proceeded along similar lines. Thus a minutely regimented distribution system resembling that of an army garrison came into existence.

Since 1935 armament expenditures exceeded one-half of all government expenditures. By 1939 they surpassed 75 percent, which meant that the economic expansion did not improve civilian consumption. Under the motto "Cannons instead of butter," the government openly asked for sacrifices on behalf of national defense. The Reichsbank under Hjalmar Schacht lent its support by rediscounting armament bills and holding them for a number of years. The private bank that accepted such bills and then placed them with commercial banks or rediscounted them with the Reichsbank was a sham organization, Metal Research, Inc. (Metallforschung GmbH) that made its appearance as early as 1933. Its acceptances were guaranteed by the Reich.

After 1938 the monetarization of rearmament debt was supplemented by the issue of tax certificates that enjoyed limited legal tender qualities. Public institutions, such as the nationalized railroads and the postal service, paid 40 percent of their construction orders with "tax certificates" (Steuergutscheine) that were acceptable for later tax payments. The certificates could also be used to pay subcontractors. One type bore no interest and matured in six months; another type paid 4 percent and matured in three years. Both types constituted not only a new kind of money but also new government debt.

The Reichsbank was to undergo a radical change that made it an integral instrument of government. The banking law of 1924 had created an autonomous central bank that was responsible for the integrity of the mark and the preservation of the gold standard. A law of October 27, 1933 authorized Chancellor Hitler to appoint the Reichsbank president and its board of directors. It also granted the Bank the right to conduct open-market policies. A reform act of February 10, 1937 then placed the Reichsbank under the immediate command of the Führer and Chancellor and instructed it to attend directly and immediately to the fiscal affairs of the state. The Bank thus became an integral administrative unit of government. And yet, the Bank's board of directors under Hjalmar Schacht showed remarkable courage and independence when, in January 1939, it petitioned Hitler for monetary discipline and restraint: "No central bank can safeguard the currency from the inflationary expenditures of government." This petition, together with other annoying attempts at restraint, led to the immediate dismissal of Schacht and several board members. A new banking law of June 15, 1939 then nationalized the bank and reiterated that henceforth "the German Reichsbank was to be managed under the supervision of the Führer and Chancellor according to his instructions." The process of Reichsbank integration in the command order that permeated all economic activities had now been completed.[5]

III War Economy and Inflation (1939-1945)

The Germany currency now was de facto and de jure a fiat currency, free of any restraint and limitation. It had no ties to gold, political authorities determined its rate of expansion and volume of circulation. The Führer held final authority over all money and credit transactions and in particular, over the amount the Reichsbank would discount. Thus all preconditions were given for the "noiseless" war financing that was to follow.

The economic command system of 1939 was already a "war economy." It needed no major readjustments or changes, merely a few supplementary regulations. The ration and allocation system was extended to all important consumers goods. The newspapers would announce the available rations of food, such as bread, butter, meat, sugar, etc. For clothing, shoes, bedding, etc. coupons were issued upon application and proof of need. Surely, all allocated goods needed to be paid, but the coupon or ration card was the primary authority of purchase. The state, too, needed to pay for all its goods and services. But throughout those years of total war it never suffered from lack of money and purchasing power. Its economic problems had been reduced to the application of persuasion and force for the procurement of labor, raw materials, and facilities of production.

The German government made every effort to pay for most of its war expenditures with tax revenues. The income tax was raised immediately by 50 percent, but not in excess of 65 percent of income. Excise taxes on beer, brandy, champagne and tobacco were boosted significantly. As the corporation income tax had been raised shortly before the war it remained unchanged until August 1941 when "war supplements" were imposed. For all manufacturing it was raised once more in March 1942. Dividend payments in excess of six percent of capital stock were prohibited.

To absorb private purchasing power and tap more sources of income the state sought to collect future revenue in advance. A decree of July 1942 extracted a lump-sum payment from house owners, equal to ten years of real estate taxation, which was to discharge all future tax obligations. This device, which proved to be very productive of revenue, was presented as an opportunity for a suitable wartime investment that hopefully would induce individuals to spend less and save more.

A decree of October 1941 introduced the "iron savings account" offering certain tax advantages. Every employee could deposit 26 marks of his monthly income with a bank through payroll withholding, and half of his Christmas bonuses up to 500 marks. The account was frozen throughout the war, i.e. it was not transferable, but inheritable. It paid the same interest as other regular savings accounts. The deposits as well as their interest payments were exempt from income taxation and social security levies. He who failed to appreciate the opportunity of this savings program was persuaded through "voluntary force" to open his "iron savings account." In a similar manner, businessmen were induced to create credit accounts with the Internal Revenue Service through advance tax payments. Furthermore, they were invited to establish "commodity acquisition accounts" with the IRS. Both accounts, blocked for the duration of the war, created tax-free savings that were channelled directly to the government.

The Reich did not overlook the ancient device of extracting subsidies from the occupied countries. Bohemia, Moravia, Poland and many others had to make war contributions. Even the German states, communities and public corporations were forced to bear their fair shares. Altogether, the Reich managed to cover approximately one-half of its 1941/42 defense expenditures, or 75.6 billion marks, through taxation (32.3 billion) and other internal revenue (5.6 billion).[6]

Despite all efforts at extracting revenue from every conceivable source, huge deficits remained and grew bigger during the later years of the war. And once again the Reichsbank was called upon to grant short-term assistance through the purchase of Treasury bills. Its printing presses were rolling. But simultaneously the fiscal authorities developed an ingenious method of finance that noiselessly converted a large share of Reichsbank debt and currency to middle and long-term debt. This method made all government appeals to public patriotism superfluous, and eliminated all public campaigns and drives for the subscription of war bonds and notes. The government simply placed its medium and long-term obligations with the financial institutions that were accumulating the savings, i.e. with commercial banks, savings banks, credit unions, and insurance companies. As the quantity of available consumers goods was shrinking throughout the war, making way for greater armament production, a rising share of personal income no longer found real goods and therefore was saved. Upon deposit of these savings with finannial institutions they were immediately invested in medium and long-term obligations of the Reich.

The public was hardly aware of this ''noiseless'' war financing. The gradual impoverishment was accompanied by a rapid growth of savings that were generally mistaken for rising personal wealth. After all, everyone could watch his bank balance grow steadily, promising better living conditions in the future. Many bought new life insurance or greatly increased their coverage. Of course, those funds, too, were channelled directly to the treasuries of the Reich. When an insured amount was payable in case of death, it was deposited in a bank that would lend it to the Reich. The government thus managed to place almost one-half of its obligations in financial institutions. But unfortunately, national savings were smaller than the government demand for medium and long-term loans, which necessitated Reichsbank financing of the balance through discounting of Treasury bills. The quantity of Reichsbank notes therefore continued to rise.

Emission of Reichsbank Notes
(in billions of marks)

End of March		End of March	
1933	3.520	1940	12.176
1936	4.267	1941	14.188
1937	4.938	1942	19.774
1938	5.622	1943	24.697
1939	8.311	1944	33.792
		1945	56.400

Source: B. Schultz, Ibid., p. 246

As can be seen from the table, the quantity of Reichsbank notes doubled between 1933 and 1939. During the first two years of the war it rose by less than 6 billion marks. Thereafter it rose very quickly. From 1941 to 1944 it more than doubled, and doubled again during the last twelve months. The total quantity at the end of the war can only be estimated. Some sources set the amount at 65 - 70 billion, others even higher.

The credit expansion by commercial banks kept pace with the Reichsbank note emission. Their total liabilities rose from 50.1 billion marks in July 1936 to 276.8 billion in September 1944, of which 97.2 billion were time deposits. Their assets consisting of Treasury bills and acceptances soared from 7.3 billion to 90.5 billion, market instruments and participations from 8.2 billion to 76.6 billion, and other loans from 12.9 billion to 63.1 billion.(7)

Contrary to all principles of economics, this vast expansion of money did not lead to higher prices. The state with its awesome power and coercion "stabilized" the purchasing power of money through stop orders and rationing systems. Daily spot checks of prices, followed by public prosecutions and severe punishments, brutally defended the price structure. Wages were permitted to rise by a mere two percent in almost six years of war effort. However, total labor income rose by more than fifty percent on account of the growing labor force and the longer workday. A decree of December 12, 1939, lengthened the permissible workday to 10 hours.

A rising share of personal income no longer could buy anything and therefore was tramping about the economy. A "money surplus" came into existence that defied all government efforts at capture by the bank deposit system or the life insurance method. It formed the demand component of the "black market" that slowly grew in importance. Consumers goods became available without coupons and ration cards at higher prices and with "Vitamin C", i.e. "connections" (in German popular usage, "Vitamin B" for "Beziehungen"). Severe fines and sentences failed to suppress the budding markets.

Toward the end of the war the Allied bombing of German cities with its massive destruction of housing actually fomented the disarrangement of the monetary command order. The damage to personal property led to the withdrawal of more and more savings in order to replace the losses of furniture, household effects, clothing, etc. These funds were searching often desperately for real goods and, when none could be found through official channels of distribution, appeared on the black markets. Similarly, the "compensation funds" that were paid promptly for damages suffered often found their way to the black markets.

By 1940 the old coinage consisting of silver, nickel and copper began to disappear. But before a great deal could find its way into private hoards the government was quick to replace the old coins with its own substitutes. The Rentenbank, which in 1923 had facilitated the currency stabilization, was reactivated and issued 1 and 2 mark notes replacing the silver coins. The 50 Pfennig coins were made of aluminum, and the 10, 5, and 1 Pfennig coins of zinc. Hoarding of old coins was made punishable with fines and imprisonment.

The growing flood of paper money, and the mountains of aluminum and zinc coins were further supplemented by special issues of paper fiat with limited legal tender. In the occupied countries and territories the armed forces issued at least three additional types of notes: "credit certificates" that were provided by a special bank, the Reichskreditkasse, "auxiliary media of payment," and "clearing notes" which the armed forces created and issued without banking assistance.(8) During the final months of the war when money shipments were severely disrupted or completely prevented by air raids, the resulting shortages were alleviated through the issue of "emergency money." Reichsbank branches in Salzburg, Graz and Linz simply manufactured photo copies of 10, 50, and 100 Reichsbank notes and emitted them in Austria and Southern Germany with full legal tender quality. Many of these notes were printed only on one side. Other branches in Northern Germany issued their own "credit certificates" or those of the Reichskreditkasse that were meant for occupied territories. The Provincial Bank of Saxony created its own notes for circulation in the east. And many cities and communities in the southwest desperately printed primitive shinplaster that took the place of the Reichsbank paper lost in transport from Berlin.(9)

The monetary disintegration paralleled the military collapse of Germany. Through conquest and capitulation the Reich ceased to exist. Its money lingered on for three more years, together with coupons and ration cards, until it was swept away along with so many other traces of the Reich.

IV Monetary Conditions During Occupation (1945 - 1948)

The chaos in money and banking that had spread over Germany during the last months of the war had a paralyzing effect on all economic life. It is difficult to estimate the great depth of the collapse. But it is probably no exaggeration to state that individual income in terms of purchasing power did not exceed ten percent of prewar income. By 1947, two years after the war, when economic production had been redirected toward consumers goods and millions of former members of the armed forces and more millions of refugees had joined the production process, national income was estimated at barely one-half of the 1936 income.(10) But the quantity of money in the broader sense had grown more than sixfold, i.e. from less than $50 billion marks to some 300 billion (notes 70 billion, savings accounts 125 billion, and other bank accounts 100 billion).(11)

In 1945 and 1946 the Allied occupation forces added some 12 billion "military marks" in denominations of ½, 1, 5, 10, 20, 50, 100 and 1000 marks. They were equal to those issued by the Reich, and were used for the payment of troops and civilian employees. When the 20 mark note became the object of massive counterfeiting it was withdrawn from circulation.

The military government raised all tax rates to extraordinary levels, in particular, the individual and corporation income taxes, property and estate taxes, all excises and sales taxes. Law No. 12, for instance, imposed progressive income tax rates of up to 95 percent. The top rate applied to annual incomes of 60,000 marks and higher, which at prewar exchange rates were worth $14,285. On the free money markets in Germany as well as in neighboring countries the U.S. dollar was selling at 200 marks and was rising. When calculated at these exhange rates the 95 percent income tax rates applied to all annual incomes of $300, or $25 per month. But few Germans admittedly earned such high incomes under the wage-control system.

The fierce taxation by the Allies reflected, among others, their growing concern about the monetary situation. Surely, they could have continued to issue "military marks" until the German population as well as the occupation troops would have shunned them in a flight from all fiat monies, like that in 1923. But in 1946 and thereafter, the Western Allies chose to stabilize the situation by refraining from expanding the money quantities much further. Henceforth Allied troops were paid in their own national currencies, and military marks were issued sparingly upon special request only. Allied expenditures were borne by the Allies themselves or were covered by the revenue that flowed from German taxation. For the fiscal year 1946/47 they reported with pride that the occupation budget was in balance.[(12)]

And yet, the mark continued to depreciate, and the black markets assumed an ever greater role in the daily lives of the people. A number of psychological factors contributed to this interesting development that gave the postwar period its most significant characteristics.

The end of the war had brought a radical readjustment of outlook from mere survival under wartime conditions to a new life aimed at restoring and rebuilding individual lives and economic well-being. The German veteran who during the war had been occupied solely with the daily task of survival had completely ignored his "iron savings account." But now he was eager to withdraw his savings to rebuild his economic life and make plans for his future. When official channels of distribution failed to provide the desired economic goods his funds often turned to black markets. The situation was similar with every enterprise eager to repair and rebuild, resume operations, or just readjust from armament production to peacetime manufacture of consumers goods. They all scrambled for liquid funds in order to finance the new beginning. In most cases the black markets offered the only opportunity.

Other changes also gave encouragement and support to the black markets. No matter how severe the Allied law enforcement may have been, its fines and penalties for black market misdemeanors did not compare in severity with the punishment for economic crimes by the Nazi regime. Also, there were no more Nazis who would inform the authorities of illegal economic activities. Without much danger of informers and spies practically everyone felt free to resume his economic existence to which the black markets could contribute so much. And finally, the fierce taxation imposed by the military government gave great impetus to black-marketeering. It led to massive tax evasion and thus created "hot monies" that had nowhere to go but to the black markets.

Despite all controls ever more consumers' goods found their way from the official distribution system to the markets where prices were much higher. In 1948 the flight into real goods began to accelerate. Nearly everyone now sought to convert as much money as possible to real goods in order to escape confiscation or cancellation through the expected currency reform. An American cigarette cost 6 - 10 marks, a pound of coffee 400 - 600, and a radio 3000 marks. It was often difficult to find such marketable goods as the merchants themselves were hoarding them in the hope of selling them some day for better money.

Nearly all coins disappeared from use in exchange. Their metallic value as pieces of aluminum and zinc began to exceed their purchasing power as money. And it was commonly assumed that a currency reform would not immediately provide a new coinage, and therefore would temporarily retain the old one with new purchasing power. Therefore, postage stamps, trading stamps, and other pieces of paper served to make change while the people were clinging to their coins. No picture could depict the deplorable conditions of 1948 more vividly than that of a wretched individual guarding his hoard of small pieces of aluminum and zinc.

While the monetary order was gradually disintegrating, a particular commodity emerged as the most marketable good, serving as the favorite medium of exchange: the American cigarette. The Allied troops used it in their dealings with the population, and the Germans among each other. It could render all monetary services and as such could take its place as "cigarette currency" in most economic exchanges. It even served as the unit of calculation because its exchange value remained remarkably stable despite massive shipments from the U.S. After all, it would serve as medium of exchange just once or twice and then be withdrawn from circulation through consumption. It was an expensive currency, but more dependable and honest by far than the various issues of government fiat. It was a free currency, free of all government regulations and controls that were throttling economic life and hastening economic disintegration.[13]

The Allied Government helplessly watched official industrial output fall to 20 percent of the 1938 capacity and the shortage of consumers' goods reach catastrophic proportions. It reacted in a fashion that may be typical for military minds: it enforced with vigor and severity the Eisenhower Proclamation No. 1 that had rigidly fixed all prices at the May 8, 1945 levels. It laid the blame for the economic disorder on the Reichsmark inflation and, with self-righteous condemnation, indicted the "economic immorality" of the people who were travelling about the countryside in search of black market supplies. It never occurred to the mighty authorities that their Proclamation No. 1 and the continuation of Nazi economic controls were the primary causes of the disaster. Instead, they set out to launch ambitious "reeducation programs" and, on June 21, 1948, conducted a comprehensive currency reform.

V The Currency Reform of 1948

For the man in the street the currency reform, which the Western powers decreed suddenly and on their own without cooperation of the Soviet Union, signalled a new beginning, the dawn of a new economic era. For an economist it was the command order's final operation that proved to be successful only because the German authorities under Ludwig Erhard simultaneously conducted an economic reform. They restored the freedom of markets and thus gave free play to the inexorable laws of human action. It was the competitive private property order that gave new hope and instilled new life that was to surprise the world as "the miracle of German recovery." The Allies watched the economic reform with great anxiety and misgiving. In fact, General Lucius D. Clay, the Allied director for economic policy, sent a stern memorandum to Ludwig Erhard, the provisional German director, reminding him that the economic edicts of the military government could not be altered without prior permission. Professor Erhard's courageous answer deserves to be repeated again and again: "I did not alter your controls, I abolished them"[14]

On Saturday, June 19, 1948 the military government announced three laws on the reorganization of the currency system: a Currency Law, an Emission Law, and a Conversion Law. The first two became effective the following Monday, the latter one week later.

The Currency Law established the Deutsche Mark as the only legal tender currency and voided all other issues. In exchange for old marks each resident received 60 D-Marks of which 40 were paid immediately and 20 Marks within two months. In order to avoid duplications and other irregularities, the ration card agencies were entrusted with the distribution of the head money. All old money had to be deposited in a banking account. Businesses received an advance of 60 D-Marks per employee. State and local governments were allotted an amount equal to their average monthly revenue. The military government allocated some 12 percent of the new issue to itself.

The Emission Law gave sole authority for the issue of notes and coins to the Bank Deutscher Länder. It imposed neither reserve requirements nor redemption obligations. The maximum amount of D-Mark issue was set at 10 billion.

The Conversion Law provided for a conversion of all Reichsmark deposits with financial institutions. The basic exchange rate of old Reichsmarks to new D-Marks was set at 10 to 1. Half of the converted amount was placed in "free accounts" and made available for immediate withdrawal. However, the "free amount" was subject to a ceiling of 250 DM for individuals and families and of 500 DM for businessmen and professional people. Greater amounts required review and authorization by the Internal Revenue Service, which sought to trace and tax retroactively illegal income from black-marketeering and other unauthorized economic activity.

Half of the converted amount remained frozen temporarily. Four months later, in October 1948, seventy percent was voided, twenty percent set free, and ten percent made available for certain investments in middle and long-term obligations. In final analysis, therefore, 100 Reichsmarks deposited in financial institutions were converted to 6.5 Deutsche Marks.

Bank deposits owned by public institutions were voided summarily, e.g. those of the military government, the states and their subdivisions, the nationalized railroad and postal service. They received an original allocation mentioned above. The Conversion Law voided all Reich obligations and interbank deposits, but granted new government obligations, a cash reserve, and some capital stock to all financial institutions, thereby providing the necessary assets against new deposit liabilities.

All other debt obligations were converted at a ratio of 10 to 1. That is, all creditor claims were reduced by 90 percent. But in order to avoid any debtor profits from such a conversion, debtor obligations were reinstated fully in new marks, of which 10 percent was payable to the creditor and 90 percent to the German Government. Legislation that followed in September 1948 imposed the 90 percent levy for purposes of "equalization of war burdens" (Lastenausgleich).[15] In short, 1,000 DM of an old ten thousand mark mortgage were payable to the creditor and 9,000 DM to the German Government. The same conversion ratio applied to all corporate bonds, debentures and notes, annuities and other financial obligations of private institutions.

Wages, salaries, rents, pensions, and other recurring obligations were not converted. Similarly, obligations of partnership, inheritance and divorce, between marriage partners, parents and children, social security contributions and benefits remained unaffected.[16]

The D-Mark thus ventured upon its journey. In a conspicuous send-off and for lasting support the military government substantially reduced its tax levies. For lower income brackets the tax rates were cut in half while a steep progression was retained for higher brackets. The levy on annual incomes of 30,000 marks, for instance, which heretofore had claimed 18,803 marks, or 63 percent, was reduced to 14,418 marks, or 48 percent. The corporation income tax was set at a uniform rate of 50 percent. Excise taxes on luxury items remained at prohibitive levels, e.g. 15 DM ($3.57) on a pound of coffee.

A discussion of the currency reform of 1948 would be grossly deficient if no mention were made of the reform conducted by the Soviet military government in East Germany. In contrast to that in the West which brought forth an entirely new currency system, the Soviet reform merely reduced the stock of notes and coins and devalued certain bank deposits at various rates. This does not mean that the Soviet reform was less severe than that in the West. In fact, all bank accounts in the Soviet zone had been blocked since the summer of 1945. It is interesting to note that the Western German reform caught the Soviet authorities by surprise. They, nevertheless, conducted their 10 to 1 exchange within a few days after the Western reform by attaching validation coupons to old Reichsbank notes.

The Soviet Government sought to extend its reform to West Berlin which was occupied and governed by the Western powers. When they rejected the Soviet plan the Soviets reacted strongly. They proceeded to enforce a blockade of West Berlin with its Allied garrisons and 2.5 million inhabitants, with the intention of driving out the Western powers. The prompt answer of the West was a counterblockade of the Soviet zone and an airlift for the supply of Berlin. For fifteen months of confrontation American planes supplied the beleaguered city with needed food, fuel and raw materials.

* * *

The currency reform of 1948 was probably the most comprehensive and incisive reform in the history of fiat money. In the ideological and institutional setting of its time it was welcomed by all. After all, a flight from the fiat Reichsmark had begun and several money substitutes were taking its place. Once such a flight is under way it tends to accelerate until in a mass stampede the currency is extirpated entirely. When a currency is irreparably damaged, like the German Reichsmark of 1948, it must be replaced as soon as possible with other media. This, then, raises all the problems and issues of a new beginning which a currency reform is to facilitate.

The Western Allies chose to reestablish another national fiat system with legal tender force. It proved to be rather successful in the eyes of most contemporaries because Professor Erhard and his German colleagues provided the free market setting in which the DM began to function satisfactorily. But it raises the gnawing question of how it would have functioned under the strictures and limitations of a command order as it was established first by the Nazi regime and then reinforced by the Eisenhower Proclamation. Would such a setting not have necessitated more currency reforms in order to reduce again and again the growing quantity of money to the given supply of economic goods?

Surely, the military government with its undisputed powers over the vanquished nation could have chosen several other alternatives of reform. When the Allied armies entered Germany they could have repealed all Nazi regulations and controls, which would have restored the competitive market order and given rise to an immediate miracle of German revival. Goods prices would have soared and the Reichsmark would have fallen. But it probably would have "stabilized" with much lower purchasing power provided the military government refrained from emitting its own military marks. In fact, it is likely that after a few months of doubt and uncertainty, the shrunken mark would have become exceptionally hard as there was no Reich to inflate it. By now, in 1978, after many years of worldwide inflation, it could have been the most reliable currency in the world.

There were other intriguing alternatives of reform. The military government could have freed all economic activity from Nazi restraints and controls and continued to issue generous quantities of military marks. It could have repealed the Nazi foreign exchange controls and freed the foreign exchange markets, which in time would have brought large quantities of U.S. dollars, British pound sterling and French francs to Germany. In a massive flight from the depreciating Reichsmark the Germans would have used these other currencies as their money. It is reasonable to assume that the U.S. dollar would have become the most important currency in Germany. And now, in 1978, the U.S. dollar probably would have had a sister currency, the German "Thaler."

In a 19th century setting, the conqueror would have repealed immediately all government controls and regulations, outlawed all paper issues, and permitted only gold and silver coins with his emblem to be minted. After a short transitional period in which monetary substitutes, such as cigarettes and coffee, would have facilitated economic exchanges, large quantities of gold and silver coins would have entered Germany from abroad, or been minted in huge quantities by the smelters of gold and silverware. A high purchasing power of coins would have made it most advantageous to reprocess objects made of gold and silver in order to create the needed currency.

If the Austrians had conquered Germany and Austrian economists had conducted the reform, they would have proceeded along similar lines. In his great classic *The Theory of Money and Credit* Professor von Mises described how he would conduct a reform in "Ruritania." He would ban all money printing and permit gold to be traded freely. He would, once the market price of gold had been found, adopt this price as the new legal parity of the mark and secure its unconditional convertibility at this parity. A new "conversion agency" would sell gold bullion to the public against paper marks and buy any amount of gold offered at the legal parity. Thereafter, transition from this gold-bullion standard to a gold-coin standard would be achieved by an exchange of the mark notes for newly minted coins.[17]

When pressed for his proposal of a currency reform, this writer must confess that he would have conducted the simplest reform of all. He would pass no reform law, seek no conversion or parity, and offer no government cooperation. He would merely cease and desist from interfering with the inalienable rights of man. In particular, he would have restored immediately all economic freedoms and repealed all legal tender laws. The freedom to trade and hold gold, the freedom to use gold in all exchanges, and the freedom to mint coins would have brought forth the ideal currency to which all others could repair.

Of course, all such deliberations are idle speculations of an armchair economist. The victors of World War II chose to replace a defunct fiat currency with a new fiat system. It cannot surprise us, therefore, that the old forces of inflation and depreciation are gnawing again at the purchasing power of the Deutsche Mark. Since 1948 it has lost almost one-half of its exchange value. Surely, in comparison with so many other decaying national currencies it has performed rather well. But when compared with gold, man's money of the ages, it is a pitiful ersatz.

Hans F. Sennholz

(1) **German National Income and Government Revenue**

(in billions of Reichsmark)

Year	Nat'l. Income	Taxes	Percent
1928	71.2	25.2	35.4
1929	70.9	26.6	37.5
1930	64.6	27.1	42.0
1931	52.1	25.3	48.6
1932	41.1	22.0	53.5

Source: Statistik der Bundesrepublik Deutschland, Vol. 199, Stuttgart 1958, p. 76, *et seq*.

(2) **Reichsbank Credit**

(in billions of Reichsmark)

Year	Total	Bills Discounted	Full-Employment Bills
1932	3.448	2.806	1.904
1933	4.037	3.177	1.644
1934	4.977	4.021	2.955
1935	5.358	4.498	3.696
1936	6.108	5.448	4.643

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(6) **The Budg**
Recepits and C
(in billi

Fiscal year	1938/:
Total Outlays	31.!
Nat'l. Def.	18.·
Family Allow.	–
Interest	1.:
Amort'n. of Debt and other Obligations	1.(
Total Revenue	28.
Taxes & Tarfs.	18.
Contr. by states & communities	–
Funded debt	7.
Other rev. (b)	–
Deficit	3.

(a) Data unavailable

(b) Among others, contributions by occupied territories

Banker's Bills (Acceptances)
(in billions of Reichsmark)

Year	Total	Full-Employment Bills
1932	9.270	—
1933	8.610	—
1934	9.790	2.42
1935	12.700	5.410
1936	15.050	8.320

Heinrich Irmler, "Bankenkrise und Vollbeschäftigungspolitik (1931-1936)" in *Währung und Wirtschaft, 1876 - 1975*, Fritz Knapp, Frankfurt am Main, 1976, p. 322.

(3) Willi Albers, "Finanzpolitik in der Depression und in der Vollbeschäftigung," *Ibid.*, p. 355, 356.

(4) *Ibid.*, p. 360.

(5) B. Schultz, *Kleine deutsche Geldgeschichte des 19. und 20. Jahrhunderts,* Berlin, 1976, p. 222 - 250; cf. also C. W. Guillebaud, *The Economic Recovery of Germany,* London, 1939; J. Klein, "German Money and Prices 1932 - 1944," in *Studies in the Quantity Theory of Money*, ed. by M. Friedman, Chicago, 1956; H. Schacht, *Abrechnung mit Hitler*, Frankfurt, 1949.

the Reich
s (1938 - 1945)
Marks)

39/40	40/41	41/42	42/43	43/44	44/3-7-45
52.1	78.0	101.9	128.6	153.0	171.3
32.3	58.1	75.6	96.9	117.9	128.4
(a)	(a)	4.8	5.5	6.5	8.1
1.9	2.8	4.2	5.9	6.6	10.5
1.3	1.7	1.9	2.1	1.8	2.8
39.5	57.6	75.0	91.6	96.2	89.7
24.2	27.5	32.3	42.7	38.0	37.5
.8	1.4	1.4	1.6	2.0	2.5
6.6	18.5	22.9	22.0	28.4	21.0
—	6.1	12.2	18.9	20.3	23.6
12.6	20.4	26.9	37.0	56.8	81.6

upation costs.

Indebtedne
(193
(in billio

	End of Fiscal Yr.	1938/3
I	Total Treasury Debt	30.7
	consisting of	
	(1) Old Debt incurred before 4/1/1924	3.4
	(2) New Debt	27.4
	(a) foreign	1.3
	(b) domestic	26.1
	consisting of	
	long and medium term	19.6
	short term	6.5
	consisting of	
	Try Bills	6.1
	Acceptances	.4
II	Other Debt [(a)]	.2
III	Private Bills guaranteed by the Reich	11.9

(a) Tax credit certificates, production and supply del

Source: *Statistisches Handbuch von Deutschland,* th p. 555.

(7) B. Schultz, *Ibid.*, pp. 246, 247.
(8) For a discussion of the inflation in occupied countries see A. J. Brown, *The Great Inflation 1939-1951*, London, 1955, p. 28 *et seq*.
(9) Cf. G. Schmölders, *Geldpolitik,* Tübingen and Zurich, 1968, p. 344 *et seq*.
(10) F. Grünig, "Die Wirtschaftstätigkeit nach dem Zusammenbruch im Vergleich zur Vorkriegszeit" in *Die deutsche Wirtschaft zwei Jahre nach dem Zusammenbruch*, Deutsches Institut für Wirtschaftsordnung, Berlin, 1947, p. 70.
(11) Karl-Henrich Hansmeyer und Rolf Caeser, "Kriegswirtschaft und Inflation (1936 - 1948)" in *Währung und Wirtschaft*, *ibid*., p. 418.

the Reich
45)
Marks)

39/40	40/41	41/42	42/43	43/44	end 44/of war
47.9	86.0	137.7	195.6	273.4	379.8
3.2	2.9	2.7	2.6	2.4	2.1
44.7	83.1	135.0	193.0	271.0	377.7
1.2	1.2	1.2	1.2	1.2	1.3
43.5	81.9	133.8	191.9	269.8	376.4
25.5	43.7	66.9	88.4	115.6	135.4
18.0	38.2	66.9	103.5	154.2	241.0
11.3	21.3	35.1	57.5	88.9	102.7
6.5	14.9	26.0	37.3	61.2	116.0
4.2	3.7	4.4	2.1	1.9	2.0
11.4	10.8	10.1	9.5	8.8	8.1

ed services certificates

derrat of the American Occupation Zone, Munich, 1949,

(12) B. Schultz, *ibid.*, p. 252.
(13) Cf. G. Schmölders, "Die Zigarettenwährung" in *Kölner Universitätszeitung*, 1947, Vol. 5, p. 70.
(14) Volkmar Muthesius, *Augenzeuge von drei Inflationen*, Frankfurt am Main, 1973, p. 111.
(15) Between September 1948 and August 1952 Allied and German legislation established an "equalization of war burdens fund" that was to compensate refugees and victims of war damages. It paid a bonus to those owners of bank deposits, debt instruments, and life insurance contracts who were holding them since 1939 and earlier. For them the bonus improved the conversion ratio to 2 DM for 10 Reichsmark. All profits from debt conversion

were assigned to this fund. In addition, the equalization laws placed an indenture of 50 percent of market value on most personal and real property. It was payable over thirty years and carried an interest of 4 percent.

(16) Hans Möller, "Die westdeutsche Währungsreform" in *Währung und Wirtschaft*, *ibid*., p. 433-483.

(17) Ludwig von Mises, *The Theory of Money and Credit*, The Foundation for Economic Education, Inc., Irvington-on-Hudson, N.Y., 1971, p. 435.

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