Germany after unification: Debt crisis becomes unsustainable

by William Engdahl

The following, focusing on 1989-95, is excerpted from a broader German-language study of the economic disintegration of Germany over 1966-95.

The political actions behind the process of German unification after the fall of the Berlin Wall in November 1989, were of a far different quality from the economic actions which ensued. While the political determination to forge a reunified Germany after some 40 years of division must be praised as an act of highest courage in the face of ferocious opposition, not the least from Germany's supposed allies Britain and France, the economic policy imposed on the former five East German states after July 1990, most especially after the assassination of Treuhand chief Carsten Detlev Rohwedder in April 1991, has been disastrous.

The rigid adherence of the German Finance Ministry to strict monetarist dogma in dealing with the ensuing deficits and public debt owing to these wrong economic policies, has imposed the "International Monetary Fund system" on Germany, without the IMF, something no other nation has done willingly.

Worse still, the continuing insistence of the European Union (EU) Commission in Brussels, but most especially of the German government itself, in maintaining the Maastricht goals for monetary union, has created a self-destructive policy situation for Germany in which spiralling public debt, rising taxes, weakening corporate profits, and higher unemployment are contributing to an economic and fiscal collapse not seen since the end of the 1920s. The following article details the debt explosion under way since 1989, and how, if current IMF monetarist policies are continued, Germany will be plunged into an irreversible crisis of a dimension beyond even that of the early 1930s, something most citizens of the postwar period have become deluded into believing could never again occur.

Treuhand: The mistakes come into the budget

The federal government in Bonn in July 1990, and subsequently, carried out the equivalent of what in American corporate bankruptcy law is called a Chapter 11 bankruptcy reorganization of the entire economy of East Germany. Unfortunately, they did so on reckless monetarist terms, putting the old debt on a higher priority than the social welfare of the Federal Republic, and honoring old debt which was not legitimate even under western law.

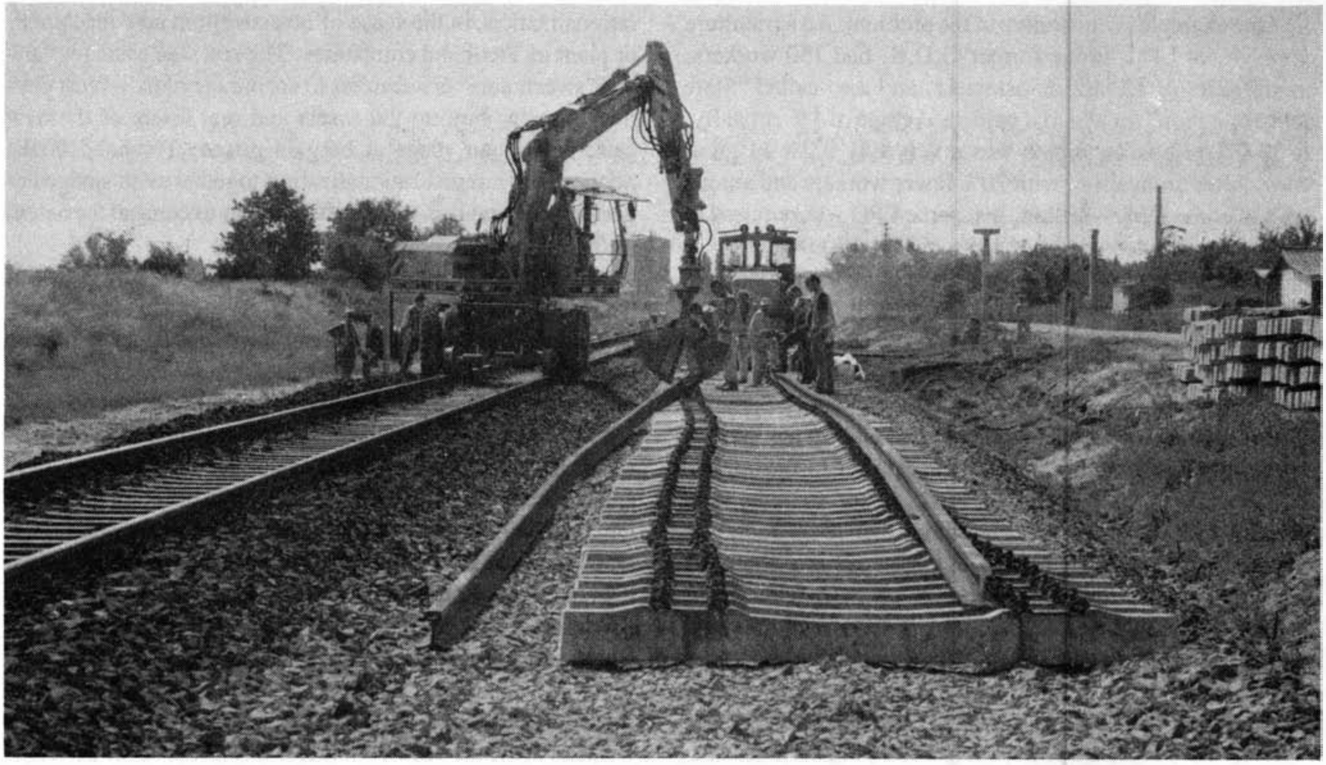
On Jan. 1, 1995, the budget of the Federal Republic reflected, for the first time in five years, the disastrous reality of the Treuhandanstalt, the agency inside the Ministry of Finance responsible for the future of some 8,000 State enterprises of the former German Democratic Republic (G.D.R., East Germany). The item appears under the budget entry, "Debt Redemption Fund."

Under this item is included 230 billion deutschemarks (roughly $145 billion) of the remaining debts of the Treuhandanstalt. As of January 1995, the Treuhand was dissolved, its mission declared complete, and a successor agency, the Federal Organization for Reunification-Related Special Tasks, and several other entities were left to clean up the remaining business. The added public Treuhandanstalt debt has brought total public indebtedness in the Federal Republic for the first time above DM 2 trillion.

The creation of the Treuhand agency itself was one of the last acts of the communist Modrow regime, in March 1990, to consolidate State industry and agriculture under one umbrella, along with their so-called debts, with an eye toward the imminent unification of the two Germanys. But the old comrades were more than a bit shrewd. Through organized street protests and other propaganda, they created enormous pressure on the Bonn government of Chancellor Helmut Kohl in the negotiations in spring 1990 to inflate the value of those old "debts."

In the final agreement which came into effect on July 1, 1990, Bonn agreed to assume the book debts of enterprises of East German industry and agriculture at a parity of two ostmarks to one deutschemark. Private household savings, in an attempt to put immediate spending power into the hands of the nervous East German population, were converted at the very generous rate of 1:1. Those private savings were not that enormous, and the move was not the cause of the problem Germany faces today. Rather, it is the Debt Redemption Fund.

By allowing a 2:1 conversion, the Federal Republic assumed responsibility for an added DM 130 billion in debts under the umbrella of the Treuhand. Much has since been



Railroad construction in the eastern state of Mecklenburg-Prepommerania, 1993. From the federal Parliament to the states to the municipalities, the only agenda item under discussion is where to raise taxes and where to cut expenditures, including for infrastructure programs like railroad construction and high-speed rail development.

said about the lack of appreciation in Bonn of the deteriorated state of East German industry. But that misses the point. Perhaps as part of a complex political deal to secure German unification, the Federal Republic assumed, as legitimate, debts which were in reality fictitious. By Bundesbank (German central bank) calculations, assuming a repayment of DM 17 billion, including annual interest charges, it will take an entire generation to repay only the Treuhand debts!

One of the final official acts of the communist People's Chamber in East Berlin shortly before July 1990, was to pass a law which allowed the East German Staatsbank and related State banks the option of charging interest on their "loans" to the Volks Eigener Betrieb (VEB, the State-owned companies) and such enterprises at western or so-called "market" rates, rather than the typical low 0.5% then charged by the State to its own companies. Thus, the Staatsbank increased its interest charge by some twentyfold, hours before the final monetary union was to come into force, a simple trick by which the East German SED (communist party) added as much as possible to the paper value of assets being "sold" to Bonn.

But in addition to the higher interest rate costs, the old communally owned factories and farm cooperatives now under the control of the Treuhand had to value their debts at a rate of 2:1 to the mark. This, despite the reality that the price structure of G.D.R. industry was oriented entirely toward the very low productivity levels of the Soviet and eastern European socialist economies. While VEB exports to the East collapsed almost entirely after 1990, the old debts on their books did not.

But, because the Treuhandanstalt was treated "off balance sheet" until January 1995 by a decision of the Bonn Finance Ministry, few realized the explosiveness of the debt time-bomb building, until a vast array of new consumer and other taxes was levied in 1995 to pay the greatly increased debt burden now on budget.

Extreme 'shock therapy' applied

The decision to assume old debts at all was bad enough, but why at a rate of 2:1? Even assuming those debts were legitimate juridical debts in the western sense, which they were not, 2:1 was absurd. Some months before July 1990, the Berlin black market valued ostmarks at 10:1. And if a measure of actual per-man productive output of the East German industry were used in comparison with West German productivity levels, a ratio of 13:1 would have been realistic. A 13:1 rate for the communally owned factories' old debt in no way affected individual private savings, which were treated separately anyway. Had, say, 13:1 been used instead of 2:1, the assumed old debts of the Treuhand firms on July 1990 would have been DM 20 billion, not DM 130 billion, even though that sum itself would still be illegitimate.

One example is illustrative of the problem. An agriculture combine, or LPG, in the former G.D.R. had 150 workers, annual sales of 15 million ostmarks, and a so-called "State debt obligation" on which it paid an average of 1% annually, or 28,000 ostmarks, which was a very tiny 0.2% of gross sales. After unification, with 30% fewer workers and annual sales of some DM 5 million, that same LPG was required to pay an annual interest cost of 10%, or DM 140,000.

If West German industry and agricultural enterprises had been forced to operate under such financial burdens as imposed on the Treuhand firms after July 1990, it could be safely said that no single West German industry would survive. The terms given the Treuhand were a "shock therapy" many times more extreme than that imposed by the IMF on Russia and Poland, and were the consequence of the inflated 2:1 valuation of those old debts. It was absurd to honor such G.D.R. "old debts" at all, given that they were merely a control mechanism for the G.D.R. State Central Planning process and not liabilities incurred for expenses in the western sense. But those old debts have, in fact, been honored, and that at absurd valuation after 1990.

After Rohwedder, a policy change

That was not the entire problem. Following the assassination of Treuhand chief Rohwedder in April 1991, the Treuhand underwent a complete policy reversal. Under Rohwedder, after intense political lobbying, Bonn agreed that the first priority of the Treuhand was to make the roughly 8,000 firms under its control into agro-industrial enterprises competitive by western standards. The priority was "rationalization, instead of privatization." Rohwedder understood that it may take a decade or more under State ownership before many enterprises in East Germany could be competitive on western terms. In the meantime, the State was to provide the basis of maintaining them as productive agro-industrial businesses.

When Birgit Breuel, a Hamburg banker's daughter, replaced Rohwedder as head of the Treuhand, radical Thatcherite "free market" ideology came to reign supreme. British or American "market-oriented" management consultants were brought in to assess Treuhand firms. The priority was to privatize as fast as possible, not to invest in new technology. A monetarist ideology, a policy which can accurately be termed "accountant's psychosis," replaced the measured, industry-oriented approach of Rohwedder.

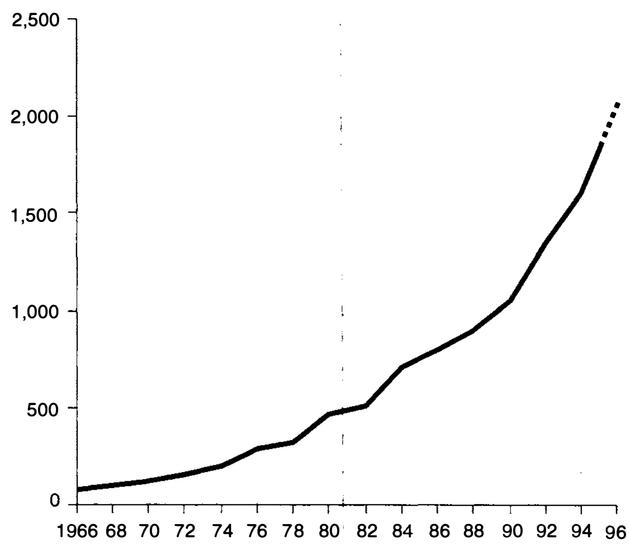
According to one study by the German Trade Union Federation's Institute for Economics in Düsseldorf, Breuel's Treuhand deliberately hid this policy shift ("privatization, instead of rationalization") through various accounting tricks. All was dumped in the accounting report under the heading, "Payments for Rationalization, Privatization, and Closings." According to the study of the institute, of the DM 77.5 billion included in 1993 under this category by the Treuhand, only DM 5 billion could legitimately be called rationalization, in the sense of investment in new machinery or plant of Treuhand companies. The rest was costs for various "sweeteners" or subsidies to encourage mostly West German firms to buy up the assets and real estate of the new eastern German states at bargain prices. Treuhand books deliberately lumped rationalization together with such categories as capital loss write-offs, in order to conceal the extent of this.

Now, under the new Treuhand policy, the initial sum of "inherited" old debts (DM 130 billion) began to balloon with new debts. Because the Treuhand paid incentives to private buyers, or kept certain large communally owned factory remnants operating with no new capital investment, merely keeping the doors open until they could be sold off, the Treuhand added to this initial debt burden enormously. Between 1990 and the end of 1994, the Treuhand borrowed an additional DM 135 billion. During that same time, it registered some DM 35 billion in receipts from privatizations, or a net added debt of DM 100 billion, for a total of DM 230 billion, which, as of Jan. 1, 1995, has become part of the federal budget. But the sum is expected to grow to DM 400 billion by 1997.

The Treuhand is only a part of debt burden

However, the added debts and interest costs of the Treuhand are only part of the increased debt burden since 1990 (see **Figure 1**). In four years, 1991-94, the federal government, through its special German Unity Fund, raised debt via new bond issues for DM 142 billion, to finance various aspects of the reconstruction of the bankrupt new eastern

FIGURE 1
The growth of German federal, state, and municipal debt
(billion marks)



states. To fund the Social Security Insurance program for the population in the new states during 1991-95, required an additional DM 257 billion. Then, a budget category entirely apart from the Treuhand, Unification-Related Expenditures, over 1991-95, had drawn an additional DM 363 billion. These expenses were projected to remain near DM 110 billion annually through 1997. In total, all financial transfers from the federal government to the new eastern states for the four years, excluding the Treuhand, have reached DM 804 billion, with another DM 200 billion annually expected to be needed through 1997.

Much of these financial flows into the eastern states goes toward building long-term infrastructure, and is essential. We discuss here only the implications for the overall debt burden of the German economy.

A major fiscal trick to disguise the enormous size of the growing indebtedness resulting from the capital transfers into the eastern states since 1990, has been the proliferation of special "off-budget" items, or "subsidiary budgets," similar to methods used by the U.S. Congress after the huge budget deficits of the 1970s and 1980s.

The largest such subsidiary or off-budget case is the Treuhand. The German Unity Fund is a second major off-budget fund. This special fund originally was intended to serve as transitional revenue support for states and municipalities in the east through 1994, at which point it would decline in importance. That proved far too optimistic, and another allocation had to be made by the Finance Ministry, financed by an increase in the value added tax (VAT). The total expenditures during 1990-94 for the German Unity Fund debt rose to DM 146 billion. Of this sum, DM 95 billion had been in the form of new debt which, after 1995, must begin to be repaid out of the federal, state, and municipal budgets at a rate of DM 9.5 billion per year. This is to extend over two decades, because of added interest costs.

As well, the Kreditanstalt für Wiederaufbau, the old German Marshall Fund agency, under its so-called European Recovery Program Special Fund, was reactivated to issue subsidized loans to projects in the eastern states. The ERP Special Fund total debt was increasing at a rate of DM 16 billion a year by 1993.

In addition, at the time of the July 1990 Monetary Union, another special fund, the Debt-Processing Fund (Kreditabwicklungsfond) was created to assume costs in the context of currency conversion, as well as meeting State budget obligations of the former G.D.R. after unification. This fund has been estimated at DM 140 billion. The major part of it, DM 110 billion, consists of liabilities to the Currency Conversion Equalization Fund.

These sums do not include other special funds, such as that set up in 1994 to consolidate the combined debts of the West German and former East German railways, at that time with a debt of some DM 70 billion. Nor do they include the DM 104 billion debt of the German postal system.

Interest payments in 1994 alone on the total federal debt, including these various hidden or subsidiary budgets, exceeded DM 120 billion. The share of Germany's combined public sector budgets had risen by that point to a staggering 52% of German gross domestic product (GDP), up from 45% in five years.

A new debt crisis

But the soaring indebtedness of the federal government budget was not the only area of public finance after 1989 to go into a debt crisis. Partly as a consequence of the "solidarity" cost-sharing agreements regarding the burden of financing the economic reconstruction of the five eastern states after 1990, and partly as a consequence of the most severe postwar economic "recession" after 1992, German states and municipalities entered their most severe deficit and debt crisis of the postwar period.

Following several years of significant effort, the state governments in West Germany had managed, by 1989, to bring the level of their deficit spending down to the relatively manageable sum of DM 7.5 billion per year. Total debt outstanding of all states in 1989 stood at DM 310 billion. By 1990, that picture too began to change, as state tax receipts fell sharply following federal tax reduction legislation, more than doubling the combined deficit to DM 19 billion, where it steadied itself until 1993. At that point, the severe economic downturn and increased requirements on western states to assume more of the burden for the east, forced state deficits to the unprecedented level of DM 27 billion by 1994. Accordingly, state debt ballooned by more than 30% in four years to a level of DM 414 billion by the end of 1994, a level, which, if sustained, would cripple state governments with severe interest rate burdens for years to come.

Not surprisingly, municipal budgets began to go into deficit, and certain larger cities faced severe crises in providing services. Even during the several years of strong growth in 1990-92, the so-called "consumer boom" era of the new states, western municipalities as a whole went into deficit, owing to huge new social costs for the elderly and others, providing for a significant inflow of political asylum-seekers and refugees from former Yugoslavia and other regions, and providing minimum social assistance to more than 2 million German households whose unemployment benefits had expired.

Then, as the severe economic decline struck after 1993, the financial condition of cities slid precipitously. Going from a combined budget surplus of DM 2 billion in 1989, the cities and municipalities by 1990 had a deficit of DM 3.5 billion, rising to DM 5.5 billion by 1991 and DM 9.5 billion by 1992.

Total municipal debt exploded from DM 111 billion to over DM 127 billion at the beginning of 1993, and to DM 138 billion by the beginning of 1994. Frankfurt had by far the most dangerous debt exposure of large German cities in relation to revenue, followed closely by Duisburg, where the dismantling of the steel industry had had a severe local impact. As well, Hanover, Cologne, Düsseldorf, and Bochum all had developed serious municipal debt burdens by the mid-decade.

The immediate response to the crisis has been for city governments to slash services drastically. According to a recent survey of its municipal members, the central council of the German Conference of Cities found that 56% of all German municipalities plan to cut outlays for road maintenance, 45% will cut education outlays, 41% plan to cut or close service in public libraries, and numerous cities will restrict expenses for theater and opera, as well as public swimming facilities.

Already, according to the German Construction Industry Association, over the past three years public municipal outlays for infrastructure construction, accounting for inflation, have fallen below the level of 1965. And new politically motivated laws on municipal waste disposal and water treatment, many of which have no justification on any environmental grounds, will force crowding out of more essential municipal services, while private households and industry face enormous added surcharges for "environmentally correct" waste disposal.

Even more alarming to German cities are impending legally mandated cost outlays to construct universal daycare facilities, arising from 1992 legislation. As well, mandatory (if unnecessary) installation by municipalities of a third cleaning stage for sewage plants, to be completed by 1998 under a new Brussels EU directive, imposes huge new costs on already crisis-ridden municipal budgets.

Taxes spiral upward

The definition of "debt trap" is the point at which a corporation or government becomes so indebted as a percentage of its ability to generate revenue to repay those debts, that it must destroy itself in a suicidal frenzy of cost reduction. Debt burdens paralyze the entity's ability to act in any meaningful manner, and, ultimately, bankruptcy is the only possible outcome. In the public sector, essential services and infrastructure necessary for future growth are sacrificed, deepening the crisis. In the private sector, companies abandon R&D and investment in new technology to pay old debts, leading to falling sales and lower profits, as other, more competitive firms take over their market.

Indicative of precisely such a situation was the decision following a bitter internal cabinet battle in June 1995, to cut some 4.4% from the transportation budget of the Ministry of Commerce. According to the estimate of the German Construction Industry Association, these cuts for fiscal year 1996 can paralyze the entire DM 48 billion already allocated to "German Unity Transport Infrastructure Projects." If so, tens of thousands of skilled jobs and the economic future of parts of the eastern states will be jeopardized, resulting in even more severe unemployment costs and loss of tax revenue to governments, thus further aggravating an already desperate situation. Such is the nature of a debt trap.

The Federal Republic is rarely spoken of today in such drastic terms as being in a debt trap, let alone being bankrupt. But this is primarily a result of carefully formulated political perception. The true situation is dramatically more alarming than anyone has been willing to admit, and the crisis is only beginning.

Already in the past several years, the first fatal signs of the disease of the debt trap, the calamity which was epidemic in Mexico, Brazil, Argentina, and other Third World countries after 1982, had become evident in Germany.

Endless debates in the Bundestag (lower house of Parliament) have taken place over what further taxes to impose on the citizenry; where to cut more services; whether infrastructure, including high-speed rail modernization, is necessary; how to further tax inheritance property, and so on *ad nauseam*.

The only agenda item under discussion at present, from the Bundestag to states to municipalities, is where to cut expenditures and where to raise taxes. Whether a 50% increase in an energy consumption tax is termed an "eco-tax" or "solidarity tax," is irrelevant to those burdened with it. By summer 1995, the federal Labor Ministry was proposing to "save" DM 3.4 billion in its new budget by forcing unemployed engineers, computer specialists, and others to harvest potatoes and perform other manual labor. The plan is supposed to "save" 150,000 jobs for Germans normally taken by Polish, Portuguese, and other foreign workers!

By 1995, German households and industries had the highest direct taxation levels in history. Since April 1991, private households have been hit by the following new tax increases: The tax for unemployment insurance was increased from 4.3% to 6.5%; a 7.5% "solidarity" surcharge was added onto existing income taxes; the insurance tax was increased, from 7% to 10%; there was an increase in the tobacco tax; the VAT was increased, from 14% to 15%; there was another increase in the insurance tax, from 10% to 12%; an increase in the pension insurance tax, from 17.5% to 19.2%; another increase in the fuel tax; reintroduction of the cancelled "solidarity" 7.5% tax surcharge; an increase in the wealth tax; and yet another increase in the insurance tax, from 12% to 15%. The tax increases are by no means over.

Merely to finance federal support for the eastern states, private households, as of 1995, have been forced to take on a financial burden of DM 103 billion per year. This does not take into account what corporations or public entities have had to contribute.

Taking the combined situation of all levels of government in the Federal Republic from 1989 to present, the population has not faced such indebtedness since 1931-32. Taxation levels, even assuming the best of economic conditions, which is far from probable, are programmed to stay at the

FIGURE 2
Globalization: Jobs are leaving Germany
(% of total German production made abroad)

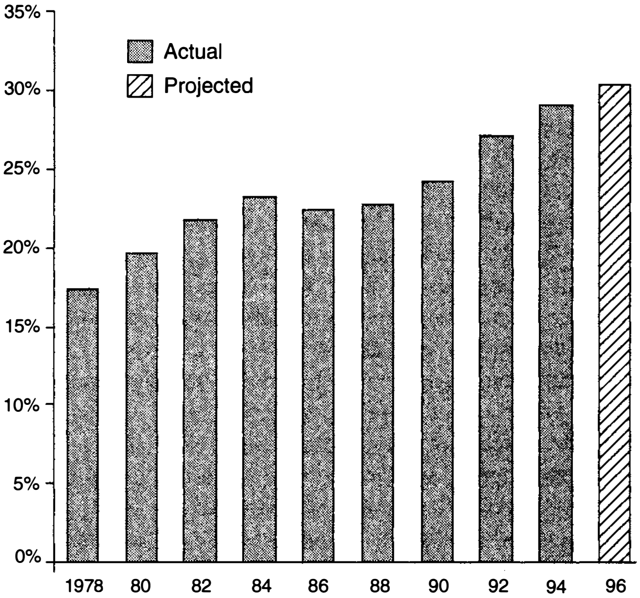
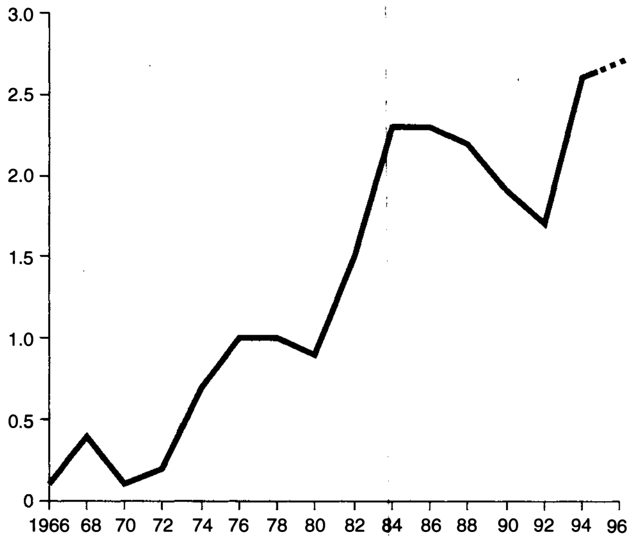


FIGURE 3
Unemployment in the western states of Germany
(million persons)



highest levels in history for years. Federal, state, and municipal debt all are at historic highs.

There is no room for fiscal or budgetary stimulus of economic growth under the present monetary assumptions of the IMF system in which postwar German economists have been schooled. The share of interest costs in the federal budget will increase over the next years for reasons indicated. According to official projections of the Federal Debt Administration, debt service, that is, interest costs and repayment of principal on only the debt of the federal government—*not* including the special subsidiary funds such as the Treuhand, the European Recovery Program's Special Fund, the federal railway, the postal service, the German Unity Fund—reached DM 142.1 billion in 1994. In 1995, this will reach at least DM 167 billion, and soar to DM 201.5 billion by 1997. But actual costs to the taxpayer of total debt, including the hidden or subsidiary budgets and other public authorities, whose combined debt today is some DM 957 billion, is vastly more than this DM 142 billion. These added sums are kept separate for political reasons. Their debt service, conservatively estimated, costs taxpayers DM 75-80 billion.

Job losses will become permanent

Further tax increases imposed by the federal government in order to attempt to reduce the size of the huge deficit and try to control the growth of the public debt, will merely accelerate trends for German industry to "downsize," by shedding tens of thousands of jobs permanently, and relocating production abroad to lower-cost locations—a process which no one in the Bundestag has even seriously considered (see **Figure 2**).

There has been no precedent in all German history for such an increase in the per-capita tax burden. The effects are already evident: By the end of 1994, official German unemployment was registered at just below 4 million, a level not seen since the early 1930s (see **Figure 3**).

Evidence of this alarming new element of permanent job elimination through "globalization," and its effect on Germany's economic future, was the fact that over the past several years, despite what is probably the most highly qualified workforce in the world, there had been no manifest trend of foreign manufacturers to locate any significant new production in Germany. The reality was the opposite: Jobs are leaving Germany. And, as existing workplaces disappeared, leaving structural unemployment behind, as has been the case since the economic crisis of 1993, costs to government increase permanently, while the needed tax base to finance those increased costs shrinks.

Pensions are the next victim

The next area to be threatened will be the Public Pensions System, where likely new pension "reform" will come into play before the end of this decade. The present trends of German demographics will mandate an explosion of legally required public expenditure for pensions, while the number of those productively employed will contract dramatically by the year 2010. Moreover, owing to the wonderful advances in medical care and technology to combat disease, life expectancy of those retirees is increasing, presenting a future scissors-effect on public pension costs.

By 1995, the per-capita debt burden from the public debt alone, on every man, woman, and child in the Federal Republic, had risen to DM 25,926. This was nearly double the per-capita public debt burden in 1989, of DM 14,935. Yet the size of the total population had increased in that time, through unification, by almost 17 million. The per-capita public debt burden in West Germany in 1975 after the oil shock, had been DM 4,170 per capita, while in the halcyon days of 1966, it was DM 1,433. Per-capita public debt has exploded in less than 30 years by some 1,800% for the citizens of the Federal Republic![1]

The fatal blow?

By the end of 1995, according to present projections, the total combined debt of government and subsidiary budgets, such as the Treuhand, federal railway, postal service, and European Recovery Program Special Fund, will have reached more than 60% of the GDP of the Federal Republic, the limit allowed to enter Maastricht. Moreover, the combined federal deficit in 1994, at DM 165 billion, had reached 5.1% of GDP, well over the 3% ceiling of Maastricht, and 1995 to date has changed little since. This puts Germany in violation of the strict monetary and fiscal rules for monetary convergence by 1997 set out in the Maastricht Treaty.

In order to ensure German adherence to the absurdly unrealistic goals initially set out by the heads of state of the 12 European Community member-states at Maastricht in December 1991, the federal government, most notably the monetarist ideologues of the Finance Ministry, have set out a course of even more severe budget austerity than has been demanded in earlier periods. This austerity will severely hit economic activity in Germany and throughout eastern and western Europe over the coming several years, if it is not soon abandoned.

The Bundesbank has repeatedly stated that were Germany to surrender the sovereignty of its currency to a single European currency, it would destroy the stability of the now strong mark and decades of Bundesbank conservative monetary policy. The mark would be dumped into a melting pot with the Italian lira, the Swedish kroner, and other currencies of the 15 EU member-nations. In the strict logic of monetarism, the Bundesbank is correct. This was the principal reason that the Bundesbank, back in 1991-92, insisted on the stringent Maastricht "convergence criteria" prior to establishment of a European Central Bank and a single EU currency.

Whether the Bundesbank and others in the federal government pushed through such rigorous criteria in hopes that the ill-conceived EU single currency scheme would collapse well before 1997 for domestic political reasons, the reality remains that the German government, and the Finance Ministry in particular, remain riveted on meeting the Maastricht criteria. This, despite the reality that as of June 1995, only two states, Luxembourg and Ireland, strictly qualified as meeting Maastricht convergence criteria for entry. Even worse: The Finance Ministry's influential Economic Advisory Council has recommended that the total federal budget deficit be drastically below even the 3% of Maastricht. Instead, it calls for the deficit to not exceed 1-1.5% of GDP in any "normal" year. At present, such a target would require a combination of new taxes or expenditure cuts from the federal budget of DM 134 billion or more this year.

This added burden has forced a pace of austerity on Germany at just the time that its public and private finances and economy can least afford it.

While the government should be stimulating private sector growth through public spending on advanced transport and energy-intensive infrastructure to make Germany the technological standard of the world economy by the turn of the century, Finance Minister Theo Waigel, in July 1995, instead announced a budget projection for rigid austerity. He proposed the first budget since 1953 with a reduction in total expenditures. While debt service will continue to rise, under present axioms of the government fiscal strategy, well past the next century, the federal government, as things now stand, must force severe cuts in its spending for necessary economic functions to meet its Maastricht targets.

The paradox of Waigel's foolish "fiscal correctness," lies in the following. The government proposes a plan of keeping the growth in government expenses always 1.5% *below* the rate of growth of GDP. But, since today the share of all public spending comprises more than 50% of the total GDP, if, say, an annual GDP growth of 3% was to be attained, something which was greeted with glee in 1994 after the collapse of the previous two years, then the private sector half of the total GDP would have to grow by almost 5% to allow the public spending to remain 1.5% below average total GDP growth. Such growth rates for the private sector into the next century, given the deterioration of German productive and technological potentials, is unlikely, to say the least.

This leaves a very real prospect of a renewed German recession/depression far deeper and longer than that just experienced. But with soaring public debt, the government will be paralyzed, in the best of external circumstances, to correct that collapse of production. That is, so long as it continues to adhere rigidly to IMF monetarist dogma that all debt, whether or not legitimate, is sacred, above social priorities. For the first time since the end of World War II, German society is squarely faced with this stark choice, although no politician has yet dared to present the real terms of these profound choices.

The alternative of 1948

When the monetary and financial developments, particularly the exponential increase of public indebtedness and its implications for the German economy since the 1960s, are contrasted to the decline of the physical economy over the same time span, it becomes clear why continuation of "business as usual" and the customary government fiscal "crisis management" is no longer possible.

Repeated reference has been made to the refusal of policymakers to alter the axioms of the postwar IMF system. We introduce here an important and little-discussed aspect of the success of the postwar German "economic miracle." Had Germany, then still under the Allied Control Commission's management of its economic and monetary affairs, been forced to follow the same rules of the IMF system as the Finance Ministry imposed on the new states after July 1990—and on all Germany under Maastricht—West Germany would have been condemned to a depressed, stagnating existence, quite possibly under Red Army domination.

A vital aspect of the June 1948 currency reform, was the decision to establish the new currency, the deutschemark, which replaced the reichsmark, in the context of a permanent forgiveness of most of the wartime debts of the Reich up to 1945. Just prior to the June 1948 introduction of the reform, the situation had been critical in all respects. The production capacity of the German economy had been cut in half by the war. From 1935 through the end of the war in 1945, Reich debt had expanded massively, from RM 15 billion to over RM 400 billion. The one thing citizens had a surplus of, as in Russia today, was paper currency, because there were no goods in the shops to buy and wartime monetary expansion had created a vastly inflated financial structure after the war's end.

Three separate laws were enacted as part of the June 1948 currency reform, the details worked out for more than one year between the American Occupation Military Government U.S. (OMGUS) and Ludwig Erhard, then economic director of the Economic Council of the Bi-Zone. The first law established the deutschemark, whose notes had been secretly printed in America and brought by U.S. military aircraft to Frankfurt. From June 18 on, all reichsmark notes would be exchanged on a per-capita quota of RM 60 for DM 60, that is, 1:1.

A second law established the German States Bank [Bank Deutscher Länder], based in Frankfurt, as the exclusive institution of issue for the new deutschemarks.

The third law practically erased all wartime debts from the public budget of the Federal Republic. In addition, because at that point municipal and state indebtedness had remained relatively low, their debts were brought into the new budgets after June 1948 at a value of 10:1, that is, reduced in nominal terms to only 10% of the reichsmark value. Over a period of months, in 1952, at the so-called London Debt Conference, in which Hermann Abs represented the position of the German government, a second debt agreement was reached, this concerning the foreign debt of the Reich prior to 1945, most especially the outstanding loans received by Germany prior to 1933 under the Versailles Treaty and the subsequent Dawes and Young plans.

These two acts of debt forgiveness, one for the domestic federal budget, the second for the external indebtedness, served a critical role in allowing West Germany to rebuild its industry and reestablish its economy on a viable basis after 1948. They should serve as poignant reminders to people today that there is nothing sacred about debt.

Were the debts of the former G.D.R., most especially the several hundred billions arising from the Treuhand policy after April 1991, to be treated in a similar manner—isolated, frozen, and devalued to a proper level—the prospects for genuine German and European economic growth and prosperity, at least from the financial side, would not be quite so bleak. Failure to reassess such IMF "rules of the game," using the kind of bold terms done in 1948 or in 1952, has created a crisis over the period after 1966 to the present which cannot be sustained many months more. Moreover, unlike 1948, today the world's largest economy, the United States, is in a crisis condition even worse than that of the Federal Republic. So, too, the world's second most important industrial economy, Japan, where, since 1989, Japanese banks and financial institutions have been choked in more than $1 trillion worth of bad debts from the real estate and financial speculation mania of the late 1980s.[2]

At this juncture of world economic and financial events, no monetarist gimmicks of hiding Germany within a "European Prosperity Sphere" is feasible. The Maastricht Treaty was intended as a straitjacket to control especially German industrial growth in eastern Europe after unification, not as a sound basis for steady expansion of infrastructure and industry of all Europe, as politicians have claimed.

Notes

1. Karrenberg, Hans and Münstermann, Dr. Engelbert, "Städtische Finanzen '95: unter staatlichem Druck," in *Zeitschrift für Kommunale Praxis und Wissenschaft,* March 1995; Heilemann, Ulrich and Reinicke, Wolfgang H., "Welcome to Hard Times: The Fiscal Consequences of German Unity," Washington, D.C.: The Brookings Institution, 1995; Deutsche Bundesbank, "The Finances of the Treuhand Agency," in *Deutsche Bundesbank Monthly Report,* April 1994; Deutsche Bundesbank, "Die Bedeutung von Nebenhaushalten im Zuge der deutschen Vereinigung," in *Deutsche Bundesbank Monatsbericht,* Frankfurt am Main: May 1993; Hankel, Wilhelm, *Die sieben Todsünden der Vereinigung,* Berlin: Siedler Verlag, 1993; "Jahresbericht der Bundesschuldenverwaltung: 1994," Bad Homburg, 1995.

2. Chorafas, D.N. and Steinmann, Heinrich, *Off-Balance Sheet Financial Instruments,* Chicago: Probus Publishing Co., 1994; Kostolany, Andre, *Geld: Das grosse Abenteuer,* Munich: Verlag Kurt Desch, 1972; Dreiaig, Wilhelmine, "Zur Entwicklung der öffentlichen Finanzwirtschaft seit dem Jahre 1950," in Deutsche Bundesbank, "Währung und Wirtschaft in Deutschland 1879-1975."