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The economic situation in germany

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After the Realignment

On December 1971, the Group of Ten finally agreed upon an international realignment of exchange rates. Which effects will this agreement have on the German and US-economy? And how will international trade develop in the future? These are some of the questions put forward to Dr Otto A. Friedrich, President of the Federal Union of Employers' Associations of Germany, and Professor Charles P. Kindleberger, Massachusetts Institute of Technology, USA, in the following interviews.

The Economic Situation in Germany

Dr. Otto A. Friedrich, Düsseldorf

Dr Friedrich, at its meeting in Washington the Club of Ten has reached agreement on new exchange rates. Do you consider this realignment a realistic one?

I should say that the realignment is, for the time being, more or less realistic although to find a truly realistic basis all currencies should have been allowed to float freely until genuine parities had emerged in response to the supply and demand. But bearing in mind all the circumstances, including the economic interests of the various countries, I believe that a solution has been found which will provide security for a certain time.

Would you say that there are winners and losers from this realignment?

Not in these terms. The Japanese and the Germans have, of course, been affected most by these adjustments. But then it must be borne in mind that the settlement is an improvement on the situation as it had arisen with the flexible exchange rates. In the weighted average of 15 different currencies the German revaluation amounts to 4.8 p.c., against 6 to 6.5 p.c. while exchange rates were floating. Most important of all, the revaluation of the Mark in relation to the Franc is, at 4.61 p.c., below the 5 p.c. which German industries considered the upper limit. I have heard from many circles in industry, e.g., the steel industry, that this rate was held to be considerably more important than the dollar rate.

Do you believe that the Washington decisions will likewise help to avoid monetary crises in the long term?

Improved Situation

I do not think monetary crises will be avoidable in the long term because of these decisions alone. After all, no real order has been established by them which would prevent the exchange rates from diverging again if different economic policies affected conditions in the individual countries. I believe that a great deal more remains to be done in regard to a rearrangement of the whole monetary system.

The Washington decisions have caused something of a calm on the external front. Will this

calm have positive effects on the economic situation in the Federal Republic?

Yes, the mere fact that calculations can be based on settled conditions enables industry—and not only manufacturing industry, but the service trades and all other sectors—to adapt better to the present economic situation. Industry and trade can cope best with this kind of situation if they operate on secure foundations. It is always a hazard in business if there is confusion about basic matters — if, as it were, the foundations are built on sand.

Are you afraid that we may slither into a recession?

I have been expecting for a long time—at least since 1968/69—that we shall gradually slither into a really big world-wide slump because the euphoria attending the technological advances and the consequent continual investment growth have given rise to the notion that we possess a kind of perpetuum mobile. Such a development however can last only as long as finance for it is assured. The first negative signs were visible as early as 1968. They became increasingly evident in 1969—which had nothing at all to do with the political situation—and then led to the general monetary crisis. There was a great danger of the individual countries, as exemplified by the USA and Denmark, resorting to self-help and defensive action, which would inevitably have resulted in a substantial contraction of world trade.

But today I have the impression that Nixon still caught the right moment for action in his own country and that the sensitive reaction of the other big industrial nations, including Germany in particular, appears to have banished these immediate

threats for the time being. I therefore feel confident about the general economic trend as determined by economic developments in the world outside.

Wage — Cost Inflation

And what about the domestic situation?

In Germany, I think, there still exist great dangers: The cost inflation, which is chiefly a wage-cost inflation and in conjunction with the currency revaluation is resulting in declining profits, and the consequent constraint on investment activity obviously contain seeds of a real recession.

But one must, of course, make a clear distinction between the various sectors of the economy. Even considering only the production industries, very great variations will be seen to exist between the basic industries such as steel and coal and the investment and consumer-goods industries. And the effect on individual firms also varies widely. Now I do not think that this has to be accepted as one of the facts of life and that businessmen should bewail their fate and put the blame for everything on somebody else, for in a free economy it is their duty themselves to take action and do what is needed to avoid, or at least keep in check, a recession which nobody wants.

The Question of "Direct Gear Change"

Should the Federal Government at this juncture already make a contribution through an appropriate economic policy or should it continue to exercise restraint?

That is a very important question. A credit relaxation, as was in fact initiated by the Central Bank Council decision of December 22, would, in my opinion,

in any case be at first to be greatly welcomed. I should not think that the present time is already right for a "direct gear change", to use the fashionable term — i.e., use of the contingency budget or even repayment of the cyclical surcharge; for the parties concerned with the wages policy, which are autonomous, have not yet found a way back to the bounds set by productivity growth.

The preconditions for state intervention will exist at the moment when the trend of costs approximates to the growth rate of economic activity and productivity and when investment restraint begins to have tangible results and unemployment figures or short-time working continue to increase.

Do you take an optimistic view of the development of costs?

One cannot be optimistic. The dispute in the German metal industry has had a happy ending insofar as a real agreement has been reached by the two sides without an arbitrator deciding the issue in the end or political intervention taking place. But the final outcome is that the 7.5 p.c. wage increase has set a signal for 1972. Wage increases of this size however are too high in relation to the growth of productivity and will have proportionate repercussions on prices and profits. Such results cannot encourage any optimism yet. We must at long last come to realise that we cannot hold our own on the international economic scene unless we create in our own house the prerequisites to maintaining or regaining our competitive strength.

Are such prerequisites also lacking in the social policy sector?

Yes, I think that there is equally a need for much more tranquillity

and security in this field. In my opinion, politicians today often fail to see that incessant discussion of new concepts of social policy creates insecurity in the economy. Take the debate on property formation by compulsory levies on profits or on mandatory investment wages and other proposals. To give an example, it is my impression that also the Federal Chancellor and other members of the Government, who, being politicians, take it for granted that the most diverse aspects of such problems should be discussed all the time, fail to see that this continuous debating is a constant source of uncertainty hampering businessmen, especially when they have to make investment decisions and long-term dispositions.

Developments of the System

But are not these discussions necessary in order to clarify the alternatives?

There is of course a need for discussions. But there is a difference between incessantly discussing that about everything in the Federal Republic needs reforming—as if the very foundation of the system had become so problematic that reforms were required in all nooks and crannies—and talking about advances within the social market economy. After all, it cannot be denied that throughout the years from 1959 to 1960, and right into the sixties, social policy and social welfare underwent further developments even though they were not labelled as reforms. They were, and are, simply part of this system. Without them the system would have no support among the population or not be regarded as really a productive order. For this reason one cannot talk of reforms for a system as if it had developed so rigidly or become so rigid in itself that it needed reforming.

There has been an especially negative reaction in the business world to the tax reform plans of the Social Democratic Party congress. Are not tax increases inevitable if projected reforms are to be carried out in education, protection of the environment, etc.?

That these matters must be tackled is beyond question. Like industry and trade, the community at large has since 1950 been facing incessantly mounting tasks. But it has been possible to discharge these tasks from the proceeds of growth without any need for continuous tax increases. In future we shall still have to trust our economy for the generating of the necessary resources by its own growth. Besides, I think that to rely primarily on higher rates of taxation is not the only, or even the most felicitous, way of coping with community tasks like pollution control, transport installations, educational services and other infrastructure problems. It would be better to think of sensible national debt arrangements, for the tasks in question will not benefit one generation alone, but also future generations which should therefore help to carry the burden. Compared with other countries the Federal Republic is not so heavily in debt that this would mean taking too great a risk.

National Debt Arrangements

Does not this form of financing involve a risk of negative repercussions on price stability?

Why should it? When the state borrows from the population via the market, it draws on money deposited with the banks as savings. It does not thereby augment the amount of money which is the ultimate determinant of inflationary price movements. There is here, I should say, a case of interaction between two things. On the one hand, there

is a genuine need to put the formation of capital on a broader basis, though it is political humbug to apply it entirely to capital for production. The bulk of the population is interested in solid investments rather than in securities which are subject to wide fluctuations, and this is where a start should be made. State loans could be made to carry certain benefits confined to the lower income brackets. And the savings available for long-term investment, which would after a while run into billions, would be admirable as a reservoir from which to finance the tasks devolving on the state. These two matters—more broadly based formation of capital and the financing of community tasks—should be tied up with each other. This, by the way, is an idea which Federal Chancellor Brandt once broached when talking to me.

Production Abroad

Do you envisage a danger of German industry increasingly shifting its production abroad in case the existing tax plans are carried out, perhaps in conjunction with projected measures for the protection of the environment?

The industries which are in a position to invest abroad—that means, essentially, the big industries—are, in my view, guided by manifold economic considerations. They do not by any means regard the pressure of projected taxation as their primary consideration. Even if this were partly the case, it would not really be such a bad thing from the point of view of the economy as a whole; for compared with France, Britain and the USA we have done far too little investing abroad since the war, which of course is due to the heavy losses suffered twice by German owners of foreign assets. There is a disproportion between our foreign investments

and the volume of our exports. The employment of large numbers of guest workers resulting from this is by no means the best solution. Before World War I Hanseatic merchants always adhered to the basic rule of reinvesting abroad at least 5 p.c. of their export proceeds. I consider this a very sound rule. Today we are, perhaps, at 2.5 p.c.

Do you think that labour-intensive types of production in particular should be moved abroad?

That could be a factor for deciding to move productions which in the Federal Republic are no longer profitable because of wage increases to countries with more favourable wage conditions. But I must repeat again that businessmen are guided by a large variety of economic considerations. Take, for instance, the case of Siemens. On the one hand, the firm decided some years back to set up certain factories for the whole

world, i.e., to manufacture in one country, say Belgium, certain components for all factories in the world. On the other hand, there are some products being made in Japan and exported to the Federal Republic. There are so many interrelated factors to be taken into account that one cannot confine the appraisal to savings in wages.

Direct Investments

Which countries, do you think, will be favoured by German industry in future — industrialised or developing countries?

That is a well warranted question. In years past a number of firms which planned well ahead for preference engaged in developing countries, their reasoning being that in these they could still gain a relatively large share of the market at an early stage and expand as the volume of economic activity grew, whereas in countries like the USA they would never command more

than a tiny share of the market. In the meantime much water has been poured into the wine because so many uncertainties and hazards have arisen in the developing countries concerning the tangible assets, remittance of earnings, etc. There is now much more interest in investing in the industrial countries proper and the market share is no longer the main issue.

Do you believe that encouragement of direct investment in developing countries may provide some redress?

Such encouragement has always been given and will, I think, continue to be given and can partly offset the existing misgivings. But many developing countries have themselves to blame for this tendency if investments to their benefit are put in jeopardy by political and economic experiments which deter independent businessmen who are used to realistic assessment.

The Future of a Free World Economy

Professor Charles P. Kindleberger, Cambridge, Mass.

Professor Kindleberger, no doubt the Nixon Economic Revolution had led to a very dangerous "money-and-trade war". How do you evaluate President Nixon's economic program?

It seems to me that President Nixon is attempting to correct a situation of crisis at home and in the international position of the United States.

Regarding the internal program of price-and-wage controls,

economists in the United States entertain a wide spectrum of opinion. Milton Friedman at one extreme believes they cannot be effective. Kenneth Galbraith at the other end has argued in their favour for some years, and believes they should be permanent. My view is that both extreme doctrinaire views are wrong. An incomes and price policy is useful in the short run for breaking up a dynamic process of wages

and prices chasing one another. They can serve to halt the edging out of the Phillips curve, if you use that technical sort of language. But they cannot last. The disequilibrium system does not behave well over time.

On the external front President Nixon's aim was to work out a series of structural changes, mainly in exchange rates and tariffs, with the hope that after that the international trade and