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# Seventy-five years West German currency reform: Crisis as catalyst for the erosion of the market order

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## Abstract

The paper analyzes the role of the 1948 currency and economic reform in West Germany for growth and social cohesion in Germany and Europe. It describes the theoretical foundation by Walter Eucken and the implementation and defense of the new economic order by Ludwig Erhard. The paper stresses the positive impact of the market economy on growth and welfare in Germany and Europe. Then, it is shown that Eucken's constituting principles of the market economy were gradually eroded after euro introduction in course of crises, with the negative repercussions on growth and equality being explained. The policy conclusion is that only the reconstitution of price stability in the euro area can prevent a further decline of welfare in Europe. The 1948 economic reforms provide an important blueprint for the necessary reform process.

## 1 | INTRODUCTION

In Germany, the communication and the public perception of prosperity have changed. Chancellor Angela Merkel still used to claim that the prosperity in Germany was at a historical peak and Germany was well prepared for the future (Christian Democratic Union [CDU], 2017). The long-term support of her governments in the elections suggested that this opinion was also prevalent among the German people. In contrast, whereas the new Chancellor Olaf Scholz has promised a new economic miracle thanks to heavy investment in climate protection (Die Welt, 2023), most

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Germans see their country in decline (Köcher, 2023a, 2023b). The Economist (2023) has dubbed Germany again as the sick man of Europe.

At the same time, given the omnipresent goal of climate protection, Germany's free-market order is increasingly called into question. The Minister for Economic Affairs and Climate Robert Habeck has announced to transform the social market economy into an ecological-social market economy (Bundesministerium für Wirtschaft und Klimaschutz, 2022). The popular journalist Herrman (2022) sees the end of capitalism as a condition for climate protection. The taxonomy of the European Union (EU), which is in force since 2022, has set the stage for a centralized allocation of capital along ecological and social criteria (Kooths, 2022).

It seems forgotten that Germany's prosperity has been based on a free-market economy, for which the 1948 West German currency and economic reforms under Ludwig Erhard laid the foundation. The current significant increase in inflation, which is unique in Germany's post-war economic history, has put the stage for a painful loss of welfare in Germany and Europe. But the resulting economic and political instability is not associated with the gradual transformation of the German economic order.

Given the 75th anniversary of the West German currency reform on June 20, 2023, this paper takes stock of the current state of the economic order in Germany. Building upon previous works by Abelshauser (1975), Buchheim (1998), Ritschl (2005, 2016), and Schnabl (2019a), it is shown how the constitutional principles of the free-market order by Eucken (1952) have become gradually undermined. The paper explains how this has resulted in declining growth and rising inequality, with economic and political instability in Germany and the EU increasing. Based on the findings, policy implications how to reanimate growth and how to strengthen political stability are derived.

## 2 | CURRENCY AND ECONOMIC REFORM AS THE FOUNDATION OF GERMAN WEALTH

The currency reform in the three western occupation zones of Germany on June 20, 1948, laid the foundation for West Germany's post-war economic recovery. Up to this point, a state command economy, price controls, public allocation of goods, and monopolization had determined the living conditions of the Germans (Buchheim, 1998). The reform was based on the coincidence of three factors. First, the US occupying forces under General Lucius Clay believed in market principles and aimed to dissolve the large cartels (Ritschl, 2016). Second, Walter Eucken (1952)<sup>1</sup> and Franz Böhm (1950) had created the academic foundations for a liberal economic and legal system. Third, Ludwig Erhard, an advocate of a liberal economic order, gained strong influence on economic policy making.

### 2.1 | Eucken's theoretical foundation

Eucken (1952) as one the founders of German ordoliberalism had developed seven constitutive principles of a market economy (see also Freytag & Schnabl, 2017). They constituted the framework for a liberal economic order which was to be embedded in a liberal constitutional state (interdependence of orders).

In the core of the system was a *functioning price system* to reflect scarcities of goods in a competitive environment. The principle has to be seen in the context of the price controls prevailing in post-war Germany. The second principle was *price stability*<sup>2</sup> to make flexible prices maintain their information function about consumer preferences and the scarcity of goods.<sup>3</sup> The primacy of monetary policy implied that price stability was a prerequisite for all other

<sup>1</sup>Eucken was an adviser of the US and French occupying forces.

<sup>2</sup>To achieve price stability, Eucken (1952) thought of a peg of money supply to a bundle of goods.

<sup>3</sup>See von Hayek (1945) on the use knowledge in the society.

principles to be effective (Eucken, 1952, p. 256). For instance, undue monetary expansion would create inflation and therefore disrupt the functioning of the price system. Government bond purchases of the central bank create more spending power for the government and therefore open the door the distortion of competition by politically influential corporations.<sup>4</sup>

*Open markets*—that is, free access to markets—were seen as necessary to maintain competition. New companies should be allowed to enter the market at any time; non-profitable companies had to leave the market. Eucken (1952) demanded the removal of international trade barriers, free choice of profession, limited patent protection, and freedom of trade and commerce.<sup>5</sup> *Private property*—particularly of the production sites—was seen as a prerequisite for competition and an efficient allocation of resources.

*Freedom of contract* was to be ensured, albeit with limits defined by the legal system, for instance, when a corporation constrained the freedom of contract of others. The *liability principle* should ensure that not only profits were privatized, but also losses were born. This should deliver an efficient allocation of resources. Eucken (1952) demanded *continuity in economic policy making* to allow economic agents to realize long-term plans without being disturbed by sudden reversals in policy decisions, as stable expectations were seen to be a prerequisite for more investment and growth. According to Eucken (1952) *all seven constitutive principles had to be fulfilled together*, because if one principle was not fulfilled, others would become undermined.<sup>6</sup>

## 2.2 | Implementation under Ludwig Erhard

The currency reform was building the backbone of a free-market order and of West Germany's economic recovery. It was initiated by the United States based on the Colm–Dodge–Goldsmith Plan (Colm et al., 1955). An important step was to eliminate the overhang of money that had been created inter alia by war financing via the central bank, because the excess supply of money disturbed the efficient use of resources. As the Reichsmark had ceased to be a reliable means of payment and store of value, most goods were rationed, which limited production.<sup>7</sup> A rapid economic recovery could be expected, as a large share of industrial plants had survived the war without serious damage (Ritschl, 2005).

The currency reform was implemented by the Western Allied forces under the leadership of the United States (Buchheim, 1998). It was based on laws passed by the Allied military government to ensure the principle of *price stability*. The German reform plan of April 1948 (*Homburger Plan*) was not implemented. A two-tier central banking system was modeled on the Federal Reserve System of the United States reflecting the new federal structure of West Germany. In March 1948, the *Bank deutscher Länder* was founded, which became the Deutsche Bundesbank in 1958.<sup>8</sup>

The currency reform was implemented on June 20, 1948.<sup>9</sup> To reduce the immense monetary overhang of the worthless Reichsmark, the population received DM 40 per capita, companies and tradesmen DM 60 per employee.<sup>10</sup> Cash and bank deposits were exchanged at a ratio of 100 Reichsmark to 6.5 DM. Debt was exchanged at a ratio of 100:10. Wages, prices, and rents were converted one to one. This induced losses for the holders of cash and bank

<sup>4</sup>That an inflationary monetary policy of the ECB undermined all other constative principles will be shown in Section 3.

<sup>5</sup>Whereas Eucken (1952) remained unclear how competition could be ensured, Böhm (1950) and Hoppmann (1968) made important contributions concerning for the design of the competition policy.

<sup>6</sup>For instance, if freedom of contract is used to build cartels, the competition is restrained, and prices do not reflect scarcities anymore. Inflation distorts the functioning of the price system. Private property can be used to exploit consumers if monopolies are possible.

<sup>7</sup>Given rising cash holdings and bank deposits due to central bank-financed government expenditure, the demand for goods and services tends to rise. If the supply is restricted, prices would rise as well. If the government aims to prevent inflation, it has to fix prices. Low administrated prices combined with large savings would lead to a hoarding of goods and a black market, which necessitate a rationing of goods to ensure sufficient individual supply.

<sup>8</sup>The new Deutsche Mark (DM) banknotes were printed in the United States and were brought secretly to Germany.

<sup>9</sup>Four days after the West German currency reform, there was a currency reform in the Soviet occupation zone. The separate currency reforms promoted the division of Germany, which resulted in the founding of two German states in 1949.

<sup>10</sup>For details, see Mayer and Schnabl (2023).

deposits, whereas the owners of physical assets (goods, companies, and real estate) gained. The so-called Lastenausgleich provided partial compensation (Hughes, 1999).<sup>11</sup>

The currency reform was accompanied by economic reforms by Ludwig Erhard, who had become in 1947 the head of the Special Office for Money and Credit in the American-British Bizone and in 1948 director of economics by the Bizonal Economic Council. Based on the “Law Governing the Principles of Planning and Price Policy after the Currency Reform” (*Gesetz über Leitsätze für die Bewirtschaftung und Preispolitik nach der Geldreform*) of June 24, 1948, prices were successively released against the resistance of large corporations. This allowed for a *functioning price system*, which could equalize supply and demand. Wage freezes were lifted.

The principle of *open markets* had been already embedded in the 1945 Potsdam Agreement, which aimed at decentralizing the highly concentrated German economy (Schmidt, 1999). In the year 1947, several laws and regulations were implemented to achieve decartelization and promote competition. Finally, in January 1958, the *Law Against Restraints on Competition* (*Gesetz gegen Wettbewerbsbeschränkungen*) came into force, which prohibited cartels and made mergers subject to the approval of the cartel office.<sup>12</sup> Erhard (1958, p. 101) argued: “Any fragmentation of the national economy into vested interests cannot therefore be allowed.”<sup>13</sup>

The Basic Law (*Grundgesetz*), which went into force in the year 1949 with the foundation of the Federal Republic of Germany, acknowledged in line with Böhm (1950) that the economic and legal orders were interdependent. It made important contributions to the liberal economic order as *private property, freedom of contract, and the liability principle* were embedded.<sup>14</sup> In Article 14, the Basic Law reads “Property and the right of inheritance shall be guaranteed.” and “Property entails obligations.”

The *continuity of economic policy making* mainly remained in the responsibility of Ludwig Erhard<sup>15</sup> who defended constantly the new order.<sup>16</sup> Monetary policy was constrained both by the independence of the new West German central bank<sup>17</sup> and the peg of the DM to the dollar under the Bretton Woods System.<sup>18</sup> When the monetary policy stance of the Federal Reserve Bank became increasingly expansionary in the second half of the 1960s (with Germany importing inflation), the German mark was finally delinked from the dollar to preserve price stability (Von Hagen, 1998).

Even though several sectors such as insurance, banking, transport, and several public monopolies remained excluded from free competition (Rhonheimer, 2017) and important market barriers prevailed (Ritschl, 2005), for large parts of the economy *Eucken's principles were altogether fulfilled*.

<sup>11</sup>The Law on Equalisation of Burdens (Lastenausgleichsgesetz) of August 14, 1952, aimed to provide financial compensation to Germans who had suffered property damage or other disadvantages as a result of World War II and its aftermath, including the currency reform. Those who had considerable assets remaining (especially real estate) paid a levy. The levy amounted to 50% of the calculated asset value by 1948 and could be paid into the equalization fund over 30 years. By spreading it over many years, the burden was only 1.67% per year, so that it could be paid out of the income value of the affected assets without having to liquidate the asset. The burden gradually became easier because of the moderate inflation since 1952.

<sup>12</sup>The law did not correspond to full competition, because it allowed for example for rationalization cartels (Rhonheimer, 2017, pp. 96–97).

<sup>13</sup>Erhard (1958, p. 136) was concerned that entrepreneurs could move from personal responsibility to the socialization of risks. He regarded cartels as detrimental for the small and medium corporations, which were not able to build cartels (Erhard, 1958, pp. 137–138).

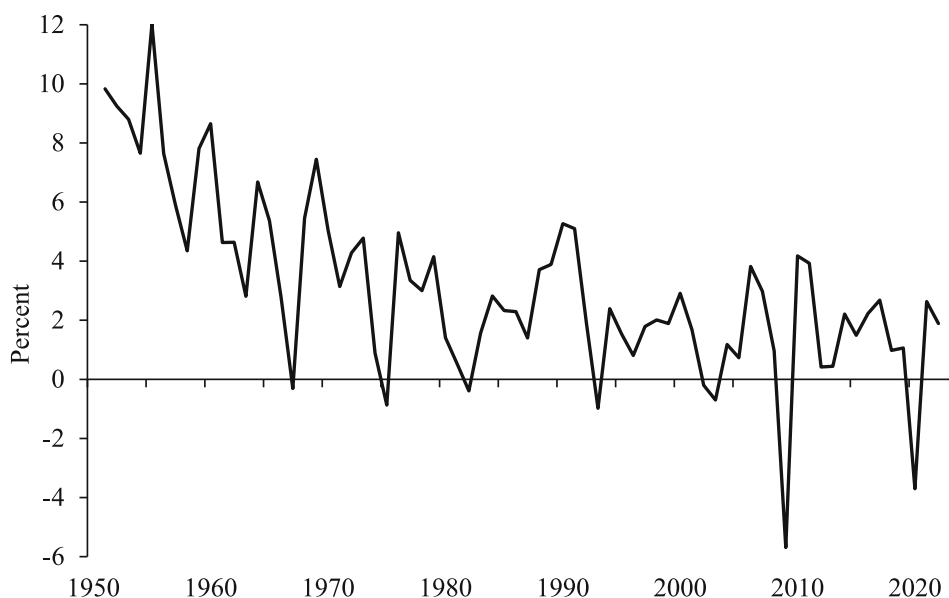
<sup>14</sup>The Basic Law also included the freedom of expression (Art. 5), the freedom of teaching (Art. 5), the freedom of assembly (Art. 8), and the freedom of association (Art. 9).

<sup>15</sup>In 1949, Erhard became Minister of Economic Affairs of West Germany, which he remained until 1963.

<sup>16</sup>As represented by the following citations: “Ich habe als Bundesminister 80 Prozent meiner Kraft dazu verwendet, gegen Unfug anzukämpfen.” (As a federal minister, I spent 80 percent of my energy fighting against nonsense.) and “Die Volkswirtschaft ist kein Patient, den man pausenlos operieren kann.” (The economy is not a patient that can be operated on non-stop.) The book written by Erhard (1958) had the title “Wohlstand für alle” (Prosperity for Everyone) in German and “Prosperity through Competition” in English.

<sup>17</sup>The Bank deutscher Länder, which was founded on March 1, 1948, consisted of the legally independent Landeszentralbanken in the individual states of the Western occupation zones (Buchheim, 1998). From the outset, the Bank deutscher Länder was independent of German state organs, including the federal government. It gained its autonomy vis-à-vis the Allies in 1951. Article 88 of the Basic Law obliged the Federal Republic of Germany to establish a currency and a central bank as the Deutsche Bundesbank. The Act on the Deutsche Bundesbank (*Gesetz über die Deutsche Bundesbank*) of 1957 defined in § 12 the independence from the federal government: “Die Deutsche Bundesbank ist verpflichtet, unter Wahrung ihrer Aufgabe die allgemeine Wirtschaftspolitik der Bundesregierung zu unterstützen. Sie ist bei der Ausübung der Befugnisse, die ihr nach diesem Gesetz zustehen, von Weisungen der Bundesregierung unabhängig.”

<sup>18</sup>Which forced the German central bank to follow the monetary stance of the Federal Reserve Bank of the United States (Holtfrerich, 1998).



**FIGURE 1** Real growth in Germany 1950–2022. Source: Germany, Destatis, Statistisches Bundesamt. From 1950 to 1990 West Germany, since 1991 unified Germany.

### 2.3 | Economic miracle, social market economy, and common market

The free-market economy could unfold.<sup>19</sup> The currency reform became one of the “most striking positive collective experiences of the Germans”<sup>20</sup> dubbed economic miracle (*Wirtschaftswunder*). Whereas price controls had led to hoarding previously to the currency reform, on June 21, 1948, the shops opened and the shelves were filled. The high demand caused production to rise to pre-war levels within a short time period (Erhard, 1958, pp. 13–15). The high growth (see Figure 1) was in fundamental contrast to the economically (and politically) fragile interwar period.

The high growth built the economic basis for a generous social security system, with the market economy becoming a Social Market Economy (*Soziale Marktwirtschaft*). The attribute “social”<sup>21</sup> was added to the market economy, with social equality being embedded in the Basic Law (Art. 20, Paragraph 1): “The Federal Republic of Germany is a democratic and social federal state.” In addition to the seven constitutive principles, Eucken (1952) had formulated four regulative principles: monopoly control, the control of excesses on the labor market (such as wages below the subsistence minimum), the internalization of negative external effects (as in the case of environmental pollution), and redistribution in favor of very low-income groups, for instance, via a progressive tax system.

<sup>19</sup>In contrast, Abelshauser (1975) argues that the high growth after World War II was more due to the post-war reconstruction. This view is in contradiction to the persistence of low growth in East Germany.

<sup>20</sup>The quote is attributed to Ludwig Erhard.

<sup>21</sup>von Hayek (1988, pp. 116–117) regarded the word social as what he called “weasel word”: “a weasel is alleged to be able to empty an egg without leaving a visible sign, so can these words deprive of content any term to which they are prefixed while seemingly leaving them untouched.” “Though abuse of the word ‘social’ is international, it has taken perhaps its most extreme forms in West Germany where the constitution of 1949 employed the expression sozialer Rechtsstaat (social rule of law) and whence the conception of ‘social market economy’ has spread—in a sense which its populariser Ludwig Erhard certainly never intended. (He once assured me in conversation that to him the market economy did not have to be made social but was so already as a result of its origin.) But while the rule of law and the market are, at the start, fairly clear concepts, the attribute ‘social’ empties them of any clear meaning. From these uses of the word ‘social’, German scholars have come to the conclusion that their government is constitutionally subject to the Sozialstaatsprinzip, which means little less than that the rule of law has been suspended.”

The academic foundation of the Social Market Economy was laid by Alfred Müller-Armack (1947, 1956, p. 390) to “combine the principle of freedom on the market with that of social balance.” He had identified three levels of sociality: First, he regarded the free market to have social consequences itself, because the market educates economic agents to be reliable and aligns the production with the preferences of the consumers. Second, the constitutive principles of the free-market order were regarded as social, because they prevented monopolies and secured monetary stability (Müller-Armack, 1956, p. 390). Only third, redistribution should lead to more equality (and contributed to the political acceptance of the market order).

The programs of the two main political parties only slowly adapted to the economic success of the reforms. The Social Democratic Party (SPD) openly opposed them.<sup>22</sup> In 1950, the Social Democrats filed a motion to remove Erhard from his office (but failed). Only in 1959, the Social Democrats admitted their support for the—now—Social Market Economy in the Godesberg Programme, including the goal of economic policy to increase wealth and to create a just distribution.<sup>23</sup> The Social Democrats also acknowledged the crucial role of a stable currency for productivity increases and wealth.<sup>24</sup>

The Ahlen program of the CDU (1947) still aimed at overcoming capitalism and socialism, stating that the capitalist economic system had failed to meet the social vital interests of the German people. Only in 1949, the CDU turned to the market economy in the Düsseldorf Guidelines (Düsseldorfer Leitsätze), which were the first self-contained draft economic order in the program history of the CDU. It combined ordoliberal ideas with the ethical demands of Christian social teaching under the label of Social Market Economy (Blank, 1967). As unemployment strongly declined (Figure 2) and the rising productivity allowed for the creation of an increasingly generous social security system, the German people supported Erhard, and the CDU remained in government until 1969.<sup>25</sup>

The liberal economic thinking in the Federal Republic of Germany influenced the European integration process, with France and Germany pursuing different approaches (Bundesarchiv Koblenz, 2015). In France, a more interventionist economic policy prevailed in line with its planification. Labor markets were rigid. This was reflected in attempts to push forward a centralized economic policy making in the EU by common institutions. France, that aimed to control the economically strengthening Germany, pursued an *institutional integration* based on common norms, rules, and institutions to unify economic policy making as a prerequisite for market integration.<sup>26</sup>

Erhard (1958, p. 211) was a decisive proponent of the European integration process, but aimed to remove market barriers to allow for competition, which would make prevail certain rules, legal provisions and economic entities (*functional integration*). Inspired by the Principles of the General Agreement of Tariffs and Trade, the IMF and the European Payments Union Erhard aimed at liberalizing trade, reducing discrimination and preventing competitive depreciations by getting accepted a level playing field at the international level (Bundesarchiv Koblenz, 2015, pp. 4–5).<sup>27</sup> The

<sup>22</sup>“It is wrong to throw the sick man into cold water and expect him to swim,” raved SPD politician Kreyßig (cited by Erhard, 1958, p. 85).

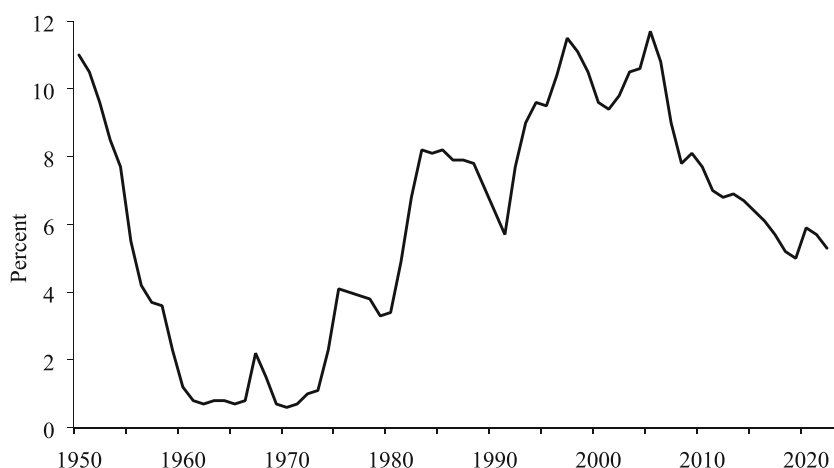
<sup>23</sup>“Ziel sozialdemokratischer Wirtschaftspolitik ist stetig wachsender Wohlstand und eine gerechte Beteiligung aller am Ertrag der Volkswirtschaft, ein Leben in Freiheit ohne unwürdige Abhängigkeit und ohne Ausbeutung.” (The goal of social democratic economic policy is steadily growing prosperity and a fair share for all in the yield of the economy, a life in freedom without undignified dependence and without exploitation.) (Social Democratic Party, 1959).

<sup>24</sup>“Die Wirtschaftspolitik muß auf der Grundlage einer stabilen Währung die Vollbeschäftigung sichern, die volkswirtschaftliche Produktivität steigern und den allgemeinen Wohlstand erhöhen.” (The economic policy must safeguard full employment on the basis of a stable currency, increase economic productivity and raise general prosperity.)

<sup>25</sup>Between 1966 and 1969 in coalition with the SPD.

<sup>26</sup>The path of the institutional integration process was taken by the European Coal and Steel Community in 1951, which was initiated by the French foreign minister Robert Schumann, who declared that “The solidarity in production thus established will make it plain that any war between France and Germany becomes not merely unthinkable, but materially impossible” European Union (n.d.). A High Authority created the blueprint for other common European institutions.

<sup>27</sup>“The best kind of integration (...) does not depend on the establishment of new offices and administrative procedures or a growing bureaucracy; it depends in the first instance on the reconstruction of a free institutional order, as best and most completely expressed in a free convertibility of the currency. Convertibility of the currency, of course, includes complete freedom of movement for goods services and capital” Erhard (1958, p. 211).



**FIGURE 2** Unemployment rate in Germany 1950–2022. *Source:* Germany, Destatis, Statistisches Bundesamt. From 1950 to 1990 West Germany, since 1991 unified Germany.

subsidiarity principle in the West German Basic Law ensured as much independence as possible in national economic policy making.<sup>28</sup>

The path of the European integration process can be seen as a compromise between the institutional and the functional approach. The institutional integration process culminated in the creation of common European institutions such as the Common Agricultural Policy, the European Commission, the European Parliament, the European Court of Justice, and finally, the European Central Bank (ECB). The functional approach led to the constitution of the common market<sup>29</sup> with the European Single Act (1986), which achieved the free movement of goods, services, labor, and capital across the borders by 1993.

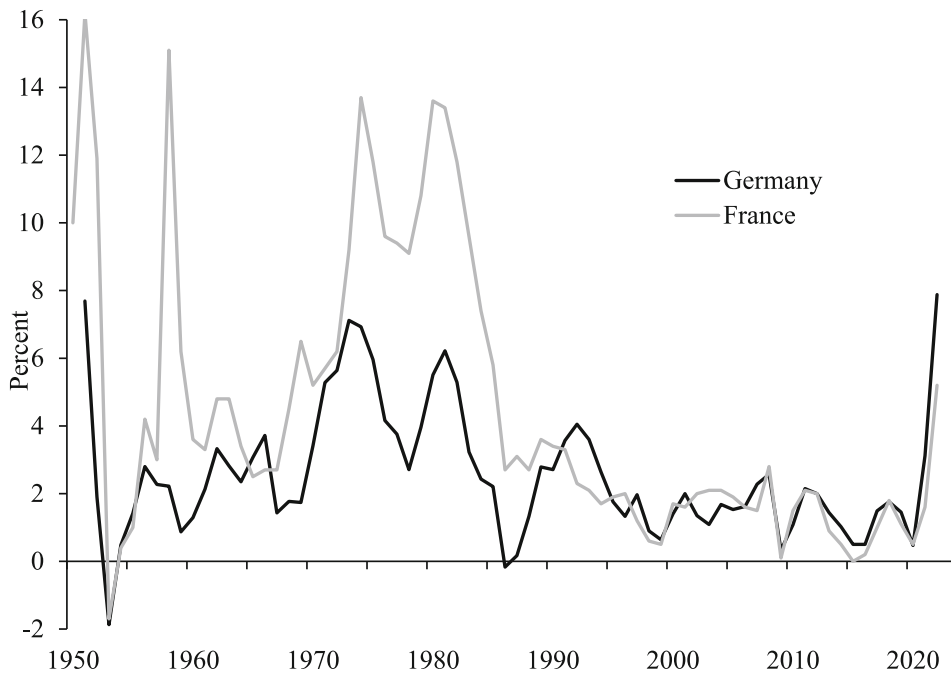
The large productivity gains resulting from the market economy in West Germany not only allowed to increase wages and to extend the social security system. It also allowed for redistribution in favor of the southern European partner countries via the common agricultural and the regional policy of the European Community. In addition, by depreciating their currencies against the DM, the southern European countries could shift parts of the productivity gains of Germany to the southern European countries. West Germany did not engage in competitive depreciations, because the Deutsche Bundesbank remained committed to price stability.

Because the gradual appreciation of the German mark forced the German industry to continuously push productivity gains forward, the currency competition within the European Community delivered welfare gains for all countries participating in the European integration process. The southern countries profited from the northern productivity gains by transfers via the common European institutions. The open markets in the European Community created additional demand for German goods. Nevertheless, the persistent depreciation pressure on the French Franc constituted a source of political discontent in France, as West Germany dominated the European monetary integration process. With the DM becoming the leading international currency in Europe, the seigniorage gains

<sup>28</sup>“With a view to establishing a united Europe, the Federal Republic of Germany shall participate in the development of the European Union that is committed to democratic, social and federal principles, to the rule of law and to the principle of subsidiarity and that guarantees a level of protection of basic rights essentially comparable to that afforded by this Basic Law. To this end the Federation may transfer sovereign powers by a law with the consent of the Bundesrat.” “The Bundestag and the Bundesrat shall have the right to bring an action before the Court of Justice of the European Union to challenge a legislative act of the European Union for infringing the principle of subsidiarity. The Bundestag is obliged to initiate such an action at the request of one quarter of its Members.” (Art. 23 Basic Law)

<sup>29</sup>Initiated by the United Kingdom under Margret Thatcher.





**FIGURE 3** Consumer price inflation Germany and France 1950–2022. Source: IMF, International Financial Statistics.

resulting from the rising demand for DM accrued to Germany (and not to France) (Herz & Röger, 1992).<sup>30</sup> The “inferiority” of the Franc against the Mark was represented by substantially higher inflation in France than in Germany (Figure 3).

### 3 | CRISES AS CATALYST FOR THE EROSION OF THE ORDER

While the rising wealth in Germany constituted the basis for more redistribution, the independence of the Deutsche Bundesbank was a control mechanism against proliferating government expenditure, as every additional expenditure obligation had to be financed by tax increases or debt. Therefore, fiscal austerity was a main pillar of low inflation. In contrast, the central banks of most other European countries such as France and Italy were subordinated to the ministries of finance and contributed to the financing of government expenditure. This not only resulted in higher inflation rates and persistent depreciations of the southern European currencies but also in the ascent of the German mark to the leading international currency in Europe.

The fall of the iron curtain at the end of the 1980s constituted a turning point, as the leading role of the DM in the European monetary integration process had created an incentive for France to substitute the DM by a common European currency (Bernholz, 1998). Among others, Marsh (2009) has argued that the French government made the consent to the German unification contingent on Germany's consent to a common European currency, later called euro.

<sup>30</sup>The French president Giscard d'Estaing had dubbed the seigniorage gains resulting from the leading role of the dollar in the world monetary system as “exorbitant privilege.” From the French perspective the creation of a common European currency should challenge the global exorbitant privilege of the dollar.

Nevertheless, the ECB had been embedded in the European treaties after the role model of the Deutsche Bundesbank. Art. 127 (1) of the Treaty on the Functioning of the European Union (TFEU) says: “The primary objective of the ESCB shall be to maintain price stability.”<sup>31</sup> The ECB was made formally independent.<sup>32</sup> The monetary financing of government expenditures was forbidden.<sup>33</sup> The bailout of overindebted governments was not allowed.<sup>34</sup> However, the ECB was gradually transformed after the role model of the Banque de France or the Banca d'Italia previous to the euro into a central bank, which directly and indirectly contributed to the financing of government expenditure (Schnabl & Sepp, 2021).<sup>35</sup> Crises justified policy decisions, which undermined price stability.

### 3.1 | European financial and debt crisis

The European financial and debt crisis is rooted in a construction failure of the European Monetary Union.<sup>36</sup> In the heterogenous European Monetary Union, monetary policy making was unified for a set of EU member states, whereas the responsibility for fiscal and social policy making remained on the national level.<sup>37</sup> Whereas a centralized fiscal and social policy would have been able to absorb asymmetric shocks (De Grauwe, 2012), uncoordinated fiscal policies triggered a divergence of business cycles,<sup>38</sup> which undermined the effectiveness of the ECB's monetary policy, putting the stage for the European financial and debt crisis (Müller & Schnabl, 2019).<sup>39</sup>

The restrictive fiscal policy of Germany came along with interest rate cuts of the ECB in response to the bursting dotcom bubble. The main refinancing rate was cut from 4.75% in early May 2001 to 2% in June 2003 and kept it at 2% until December 2005. The combination of a restrictive fiscal policy in Germany and an expansionary monetary

<sup>31</sup>“Without prejudice to the objective of price stability, the ESCB shall support the general economic policies in the Union with a view to contributing to the achievement of the objectives of the Union as laid down in Article 3 of the Treaty on European Union.”

<sup>32</sup>“When exercising the powers and carrying out the tasks and duties conferred upon them by the Treaties and the Statute of the ESCB and of the ECB, neither the European Central Bank, nor a national central bank, nor any member of their decision-making bodies shall seek or take instructions from Union institutions, bodies, offices or agencies, from any government of a Member State or from any other body” (Art. 130 TFEU).

<sup>33</sup>“Overdraft facilities or any other type of credit facility with the European Central Bank or with the central banks of the Member States (hereinafter referred to as ‘national central banks’) in favour of Union institutions, bodies, offices or agencies, central governments, regional, local or other public authorities, other bodies governed by public law, or public undertakings of Member States shall be prohibited, as shall the purchase directly from them by the European Central Bank or national central banks of debt instruments” (Art. 123 TFEU).

<sup>34</sup>“The Union shall not be liable for or assume the commitments of central governments, regional, local or other public authorities, other bodies governed by public law, or public undertakings of any Member State, without prejudice to mutual financial guarantees for the joint execution of a specific project. A Member State shall not be liable for or assume the commitments of central governments, regional, local or other public authorities, other bodies governed by public law, or public undertakings of another Member State, without prejudice to mutual financial guarantees for the joint execution of a specific project” (Art. 125 TFEU).

<sup>35</sup>Röpke (1964, pp. 236–237) had argued on the creation of a common European currency in the 1960s: “(...) if the states should agree on a common course of monetary policy, those with less monetary discipline would prevail over the few others which had more. It is disease, not sanity, which is infectious. It is always the *slowest ship in a convoy which determines the speed of the group*” (p. 236). “(...) it is likely that the highest degree of inflation in any member country will be adopted by the others along with the longest paid vacations and the greatest measure of intervention or planning. That is what, in the EEC, goes under the name of ‘harmonization’.” “(...) the member states, indulging in reckless monetary policies like Italy (and to a lesser degree France, in spite of her much-vaunted ‘planification’) will ‘export’ their inflation to other countries observing a higher degree of monetary discipline, for example Germany. In view of this monetary disintegration, it is thought that a common monetary system of the six countries of the EEC is necessary. But, here again, it is obvious that such a system supposes a common economic, financial, and social policy, which is inconceivable without a real merging of national governments into one supranational state—which is a mere phantom.”

<sup>36</sup>Given a high degree of economic heterogeneity, the probability of asymmetric shocks, that is, idiosyncratic business cycles, in the European Monetary Union was regarded to be high (Bayoumi & Eichengreen, 1993).

<sup>37</sup>Albeit Art. 126 of the TFEU says: “Member States shall avoid excessive government deficits.”

<sup>38</sup>In addition, given different institutions and different economic structures, even symmetric shocks can lead to asymmetric outcomes in different member states of the euro area. This would be an argument in favor of uncoordinated fiscal policies, which would be committed to balance out asymmetric economic developments.

<sup>39</sup>After the German unification had triggered a strong increase in government debt, starting from the late 1990s, Germany embarked on austerity measures including restrictive wage policies to contain government debt and to comply with the limits for government debt, which Germany had negotiated into the TFEU in form of the Stability and Growth Pact. The reforms culminated in the so-called Agenda 2010 under Chancellor Gerhard Schröder, which curtailed government expenditure, reduced expenditure obligations of the social security system, and made labor markets more flexible by creating a large low wage sector. The Agenda 2010 made direct reference to the Lisbon Strategy of the EU to become until 2010 the “most competitive and dynamic knowledge-based economy in the world” (European Parliament, 2000).

policy by the ECB boosted net capital outflows of Germany, which became reflected in a sharply improving current account position of Germany from 2001.

The respective capital inflows to Portugal, Greece, Spain, and Ireland—mostly in form of bank lending—boosted credit growth, wage growth, consumption, and government expenditure, accompanied by sharply rising real estate and stock prices until 2007 (Holinski et al., 2012). The resulting loss of competitiveness became reflected in rising current account deficits and rising international debt. The result was finally a financial and sovereign debt crisis, which was only resolved in July 2012 by the ECB president's Mario Draghi commitment to do “whatever it takes” to safeguard the euro (ECB, 2012).

As the crisis initiated a series of government bond purchase programs,<sup>40</sup> it put the stage for the transformation of the monetary policy towards the Franco-Italian model before the euro convergence process. The extensive purchases of government, corporate, and covered bonds were accompanied by interest rate cuts to and below zero as well as rescue credit provision of the ECB (Sinn, 2021), which stabilized the tax revenues by stabilizing the business cycle. Although officially measured harmonized consumer price inflation remained close and even below the 2% target until mid-2021, inflationary pressure could be observed inter alia in Germany in form of fast rising stock and real estate prices, thereby undermining *price stability* in this market segment.<sup>41</sup> Because the European financial and debt crisis had further entrenched the pressure on real wages, minimum wages were introduced in Germany in 2014,<sup>42</sup> restricting the *functioning of the price system* on labor markets.

The rescue measures in the European financial and debt crisis were in conflict with the *liability principle*, as banks and overindebted governments were bailed out by the monetary policy operations of the ECB and other crisis rescue mechanisms.<sup>43</sup> The restructuring of corporations in the southern euro area (and beyond) was prevented by the commitment of the ECB to keep interest rates low for long (forward guidance).

Because the European financial and debt crisis was initiated by exuberance in the financial sector, financial supervision and macroprudential measures were tightened (Deutsche Bundesbank, 2018). More reporting requirements were imposed and capital requirements for securitizations and market risks were extended. Basel III, starting in 2010 (finalized in 2017), strengthened the rules for determining capital requirements for credit risk, operational risk, and market risk implemented through the Capital Requirements Regulation (EU, 2013a, 2019) and the Capital Requirements Directive (EU, 2013b). This strongly restricted the *freedom of contract* in the financial sector.

### 3.2 | Corona crisis

In the corona crisis, which started in the year 2020, the price stability was further undermined, as the balance sheet of the ECB was further expanded via the Pandemic Emergency Purchase Programme (PEPP) (realized purchases approx. 1.713 billion euros) and the Targeted Longer-Term Refinancing Operations (TLTROs) (realized credit provision approx. 2.200 billion euros). After consumer price inflation had strongly increased from mid-2021, major representatives of the ECB claimed that inflation would remain temporary (Schnabel, 2021), which postponed the exit from expansionary monetary policy making until July 2022. The rise of consumer price inflation, which was amplified by huge central bank-financed government expenditure programs, further disturbed the *functioning of the price system*, particularly in the labor market, as unemployment was widely prevented and demand on labor markets boosted.

<sup>40</sup>In the course of the *Securities Market Programme* (SMP) the ECB purchased between May 2010 and September 2012 government and corporate bonds of predominantly crisis countries equivalent to 210 billion euros. The *Outright Monetary Transactions* (OMT) launched in September 2012 announced unlimited purchases of short-term government bonds of euro area countries under predefined conditions. Whereas OMT was never activated, in January 2015, extensive government bond purchases were decided in form of the *Asset Purchase Programme* (APP), with the most important subprogram being the *Public Sector Purchase Programme* (PSPP). By March 2023, the ECB held government bonds equivalent to roughly 4000 billion euros.

<sup>41</sup>Schnabl and Sepp (2021) scrutinize deficiencies in inflation measurement, which have kept officially measured consumer price inflation low.

<sup>42</sup>After an increasing number of German states (Länder) had introduced minimum wage clauses in their public procurement procedures.

<sup>43</sup>Inter alia multilateral bailout packages for Greece, Ireland, and Portugal, the European Financial Stability Facility, the European Financial Stabilisation Mechanism, IMF credit provision, the Target2-payment system, and the European Stability Mechanism helped to stabilize the euro area (Sinn, 2015).

Rising inflation expectations, which were enhanced by reports about lockdown measures and disturbed supply chains, facilitated price increases beyond increasing costs.

The European Council (2020) adopted a general escape clause for restrictions on government debt and suspended the Stability and Growth Pact<sup>44</sup> (until the present). In 2020, Germany paused its debt brake, which had been incorporated into the Basic Law in 2009, also to signal Germany's commitment to fiscal discipline in the EU. This further worsened expectations concerning *price stability*. A Next Generation EU Fund worth 807 billion euros provided support for the highly indebted southern EU countries with a focus on Italy for the years 2021 to 2026, which further undermined the *liability principle*. The Fund became financed via the issuance of EU bonds, which can be purchased by the ECB, although the Treaty does not allow for EU debt<sup>45</sup> and monetary financing by the central bank.

The macroeconomic response to the corona crisis perpetuated the distribution effects of the persistently loose monetary policy of the ECB in favor of large corporations via the ECB's outright purchases of corporate bonds<sup>46</sup> and via the depreciation of the euro (large corporations tend to be more export-oriented than small corporations). This conflict with the principle of *open markets* can be assumed to have been further compounded by the central bank-financed rescue packages of the German government. Subsidies tend to be over-proportionally granted to large corporations, because they are better organized in lobbying (Olson, 1965).

Regulation became pervasive in the corona crisis restricting the *freedom of contract*. The lockdown measures had redistribution effects, as small service corporations such as restaurants and hotels were forced to close, whereas industrial goods and food could be continued to be distributed (partially via online trade). The measures were politically facilitated by public compensations, which were indirectly financed by the ECB.

Real estate prices in Germany further increased, putting an upward pressure on rents. The housing market in Germany became very tight, leading to a further strengthening of rent controls. A discussion about public construction programs and the expropriation of large real estate firms set in, thereby putting into question the constitutive principle of *private property* (see Section 5).

### 3.3 | Energy crisis and climate crisis

The invasion of Russia in Ukraine in February 2022 triggered a sharp increase in energy prices. After the opening of the gas pipeline Northstream 1 in 2011 had been followed by a decline of gas prices with a negative impact on consumer price inflation,<sup>47</sup> the strongly grown dependency on Russian gas and oil imports accelerated consumer price inflation, as sanctions against Russia were imposed.

The German government introduced (like other EU countries) price caps for gas and electricity (Die Bundesregierung, 2023), which disturbed the *functioning of the price system* in energy markets. For private households and for small- and medium-sized corporations, a gas price cap was implemented. A gas price brake also supports the industry to secure production and employment, with the subsidies being linked to employment guarantees. Similarly, electricity prices were capped, and hardship assistance became provided for private households that heat with oil or pellets. As rising energy prices and inflation put further pressure on the purchasing power, minimum wages were lifted, further undermining the price mechanism in the labor market.

In the light of the climate change, which is also dubbed “climate crisis,” as part of the EU's Green Deal, which aims to achieve environmental goals such as combating climate change, reducing pollution, and protecting biodiversity, the EU (2020) created with the so-called taxonomy a classification system of environmentally compatible

<sup>44</sup>With the Stability and Growth Pact Germany had intended to shield the ECB off from pressure to buy government bonds.

<sup>45</sup>“The revenue and expenditure shown in the budget shall be in balance” (Art. 310 (1) TFEU).

<sup>46</sup>Bonds can be only issued by large corporations.

<sup>47</sup>The declining inflation justified the extensive government bond purchases of the ECB starting in 2015, after the ECB had transformed the 2% upper limit to inflation into a 2% point target (“below, but close to two percent”).

economic activities. The taxonomy is the basis for numerous regulations that shall promote sustainable economic activities. Because the need for financing is high, not only public but also private capital shall be mobilized to subsidize economic activities, which are classified as sustainable by the EU.<sup>48</sup>

From 2024, banks shall classify their loans according to environmental and climate criteria and disclose the proportion of balance sheet items that conform to the taxonomy (Green Asset Ratio). The taxonomy shall be extended to loans for medium-sized and small corporations. For the *Banking Book Taxonomy Alignment Ratio*, the banks can obtain the necessary information directly from the corporations or—if this is not possible—estimate it. Because the taxonomy changes the model of capital allocation,<sup>49</sup> it strongly restricts the *freedom of contract* and *open markets* as lobbying concerning the classification process can be expected to intensify (Kooths, 2022).

The ECB has pushed forward climate policy, while at the same time not being able to fulfill its primary goal of price stability.<sup>50</sup> Close cooperation seems to emerge between the European Commission and the ECB, which has not only announced that it will decarbonize the corporate bonds held in its balance sheet but has also made a “climate stress test” with the major banks (Largarde, 2022). A subsidized taxonomy-related credit provision by the ECB may follow in the future (Schnabl, 2022), which implies that *open markets* are further ruled out. If the centrally planned capital allocation based on the taxonomy will be financed with the help of the ECB, the principles of *price stability* and the *functioning of the price system* will be further eroded.

The persistent crisis has led to increasing subsidies, both on a European and national level. Revived economic nationalism (Schnabl, 2023) justifies an industrial policy of the EU (European Parliament, 2022a) and Germany.<sup>51</sup> Growing subsidies on a national level—for instance, for the semiconductor industry—are often granted despite the prohibition of public aid as embedded in Art. 107 of the TFEU.<sup>52</sup> As subsidies are more abundant in countries with higher GDP per capita and lower debt levels (such as Germany), they have started to undermine the common market, thereby further constraining the principle of *open markets* on the level of the EU.

## 4 | IMPLICATIONS FOR GROWTH AND DISTRIBUTION

Albeit until mid-2021 being accompanied by moderate or even low officially measured consumer price inflation, the increasingly expansionary monetary policy stance of the ECB is shown by the gradual decline of key interest rates towards and below zero (Figure 4). The ECB balance sheet has grown strongly, mainly due to unconventional monetary policy measures such as asset purchases and (Targeted) Longer-Term Refinancing Operations (Figure 5).

Eucken (1952) saw price stability as a prerequisite for the functioning of the other constitutive principles of the market order. If the monetary order was disrupted, then every economic sub-order would be disturbed (as shown in Section 3).<sup>53</sup> If the free-market order in West Germany had created high growth and a large middle class—which

<sup>48</sup>With the “Corporate Sustainability Reporting Directive” (European Parliament, 2022b), from January 1, 2024 (initially) approx. 49,000 large- and medium-sized companies are to report on the impact of their own business operations on people and the environment, as well as on the impact of sustainability aspects on the corporations.

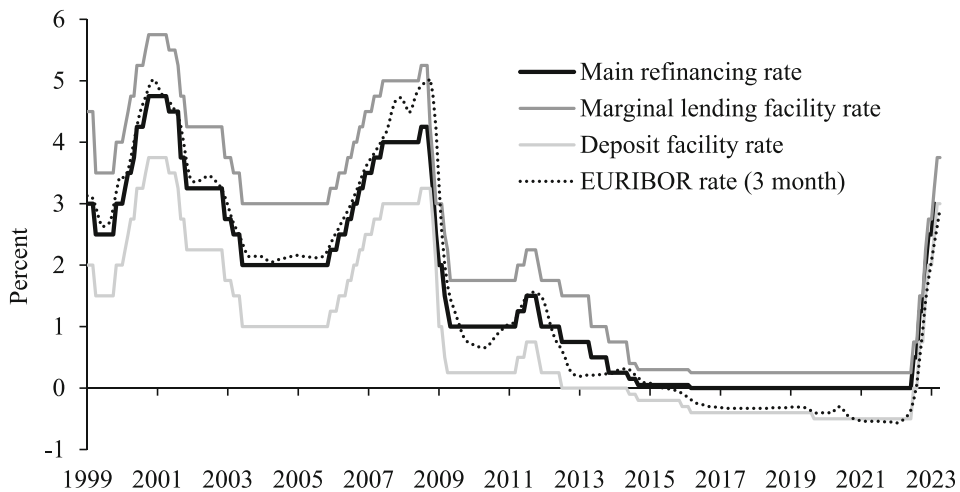
<sup>49</sup>Traditionally, (often small and medium-sized) banks in Germany have allocated household deposits as loans to (small- and medium-sized) corporations in the region. To do so, they kept close relations with the corporations in order to be able to assess the expected returns on investments and default risks of loans. As the German Bundesbank kept interest rates high to keep inflation under control, only investment projects with high expected returns were financed. This ensured high productivity gains and growth.

<sup>50</sup>This is against Art. 127 of the TFEU, which says: The primary objective of the European System of Central Banks “shall be to maintain price stability. Without prejudice to the objective of price stability, the ESCB shall support the general economic policies in the Union with a view to contributing to the achievement of the objectives of the Union as laid down in Article 3 of the Treaty on European Union. The ESCB shall act in accordance with the principle of an open market economy with free competition, favouring an efficient allocation of resources, and in compliance with the principles set out in Article 119.”

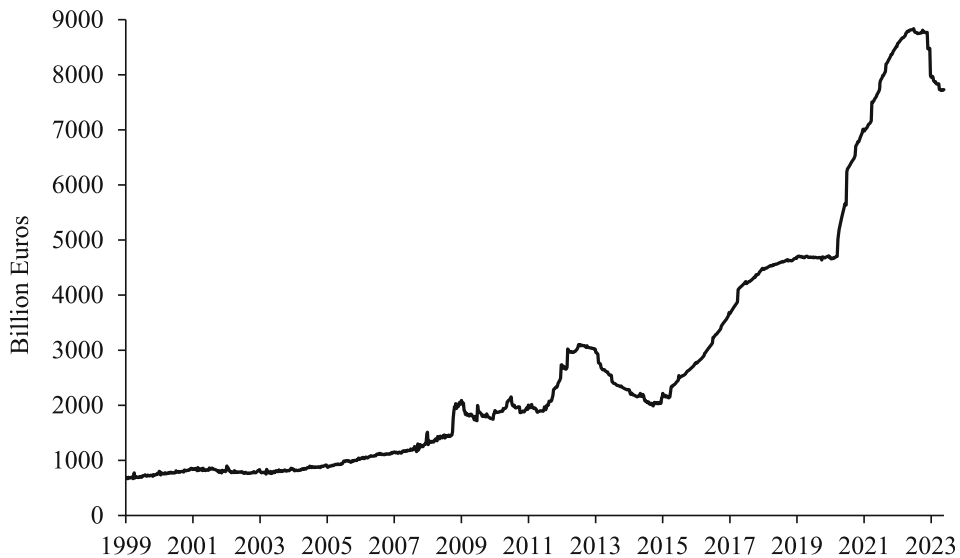
<sup>51</sup>Which would be criticized by von Hayek (1974) as “pretense of knowledge.”

<sup>52</sup>“Save as otherwise provided in the Treaties any aid granted by a Member State or through State resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods shall, in so far as it affects trade between Member States, be incompatible with the internal market.”

<sup>53</sup>“Wenn die Geldordnung gestört ist oder zerfällt, dann ist jede wirtschaftliche Teilordnung unmittelbar betroffen. Die Stabilisierung der Geldordnung ist also Voraussetzung dafür, dass die anderen Teilordnungen überhaupt funktionieren können” (Eucken, 1952, pp. 255–256).



**FIGURE 4** ECB key interest rates and money market rate. Source: ECB, ECB Data Portal.

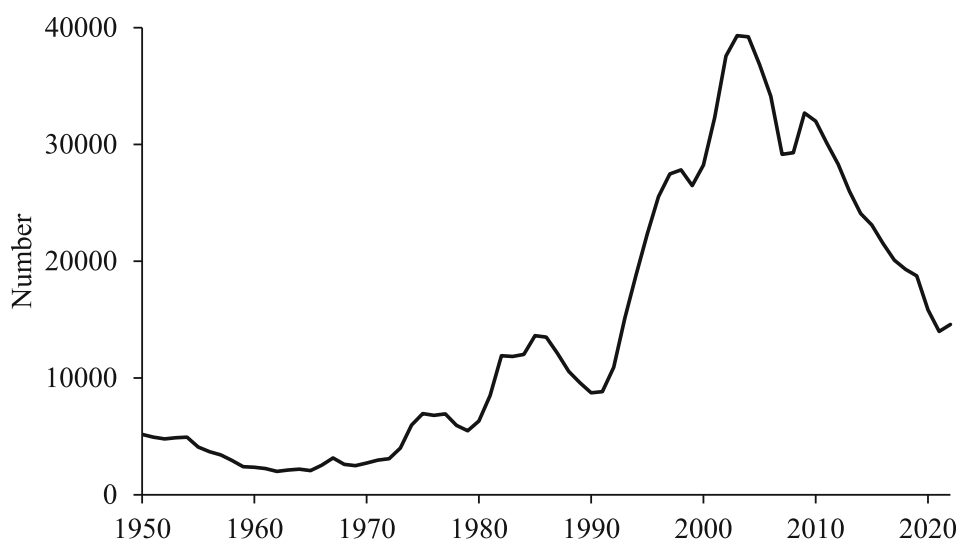


**FIGURE 5** Size of Eurosystem balance sheet. Source: ECB, ECB Data Portal.

stabilized the country politically—the erosion of the free-market order implies declining welfare and the shrinking of the middle class, that is, growing inequality. The role of Germany as a growth engine in the EU is undermined.

#### 4.1 | Negative growth effects

Up to euro introduction the stable German mark had been the backbone of a highly competitive German industry, because the appreciation of the German mark against the other European currencies (and beyond) created a persistent pressure to maintain competitiveness by increasing efficiency and coming up with innovations. The euro had a negative impact on productivity growth, because the ECB nudged interest rates to zero. In a free capital market, the



**FIGURE 6** Number of insolvencies of non-financial corporations in Germany. Source: Germany, Destatis, Statistisches Bundesamt.

interest rate has an allocation function, which separates between investment projects with high returns and investment projects with low returns. If the interest rate is held artificially low, more low-return investment projects will be realized.

According to von Hayek (1931), too low-interest rates cause unsustainable overinvestment booms, which can be accompanied by speculation booms in stock and real estate markets (Schnabl, 2019b). The resulting distortions are conserved in favor of investment projects with low (and even negative) returns, if interest rates are further cut in response to crisis. The distorted price signals come along with a declining average productivity of investment, which implies a negative impact on growth. Such overinvestment booms were observed in some southern European countries and Ireland between 2003 and 2008 as well as in Germany between 2010 and 2019. The increasingly expansionary monetary policy of the ECB in response to crises has resulted in a zombification of corporations<sup>54</sup> in the southern euro area and beyond (Acharya et al., 2020) by suspending Schumpeter's (1942) creative destruction.

If rescue measures in crisis are anticipated by corporations and financial institutions—particularly if they are regarded as *too big to fail*—moral hazard is induced, which has a negative impact on growth. The persistent low-interest rate policy of the Bank of Japan has been associated with evergreening (Peek & Rosengren, 2005) and zombification of corporations (Caballero et al., 2008). Kornai (1986) has created the concept of soft-budget constraints for the socialist planning economies. The state-controlled banking system kept unprofitable corporations by unconditional credit alive, with losses of banks being covered by the central bank. In Germany, the number of insolvencies, which had strongly increased in the wake of the unification, has for a long time continued to decline (Figure 6). The *liability principle* became largely suspended.

According to Leibenstein (1966), incentives and motivation are major determinants of a concept of efficiency which goes beyond allocative efficiency (X-(in)efficiency). Corporations do not realize all possible efficiency gains when competition is limited. Competition has become limited (and *open markets* constrained), because the ECB and the German government have contributed to a concentration in the corporate and financial sector. In the banking sector, the ECB favored concentration by depressing net interest rates margins as the traditional major source of

<sup>54</sup>A zombie corporation is seen a company that needs persistent public support to continue to operate or an indebted company that can pay the interest on its debts but not repay the principal.

income of small- and medium-sized regional banks (Schnabl & Sonnenberg, 2021). In contrast, large banks could better profit from lucrative investment banking. In the corporate sector, corporate bond purchases, euro depreciation, public subsidies, and proliferating regulation have contributed to concentration by favoring large entities.

Rising prices, first in the real estate sector and then for consumer goods and services, have disturbed the *functioning of the price system*. Price controls in the energy, housing, and labor markets, that aim to contain the loss of purchasing power, further disturb the signaling function of prices.

If low-interest rate policies contribute to fast rising real estate prices, construction booms are induced, which destabilize after their end the banking sector due to non-performing loans and tighter regulation, as observed following the European financial and debt crisis. With the capital allocation function of banks undermined, private credit tends to be substituted by public credit, with the latter one being delinked from profitability. The increasingly expansionary monetary policy of the ECB has been undermining growth via less *freedom of contract*, as it favored growing regulation, for instance, in form of more social security, environment and climate protection guidelines (Schnabl, 2023).<sup>55</sup>

Growing regulation shifts the labor force from productive parts of the production process to unproductive parts. A growing share of the labor force in banks and corporations is absorbed by a proliferating bureaucracy linked to data collection and reporting. The public sector grows because new regulations have to be made, implemented, monitored, and revised. The bureaucracy will be further compounded by the move from decentralized to centralized capital allocation via the taxonomy, which will further slowdown growth as substantial parts of the capital stock are likely to be devalued.

The rising scale of monetary and fiscal interventions, which are best reflected by the size of the balance sheet of the Eurosystem (Figure 5) and growing government expenditure have come into conflict with the *constancy in economic policy making*. Whereas in crises employment could be stabilized, unintended side effects of central bank and government interventions in form of re-emerging bubbles, excessive risk-taking, and moral hazard have been the consequence. Meanwhile, macroeconomic interventions have caused overheated labor markets, which have become an additional driving force for inflation. As the uncertainty is growing, investment and growth decline, with corporations saving instead of investing (Schnabl, 2019b).

Although the real GDP of Germany seems still at a historically record level, alternative measures of wealth point into a different direction. Real GDP has continued to grow, but real interest rates are negative since many years, and since the year 2021, the real wage level is falling. The public perception of wealth strongly hinges on the measurement of consumer prices, which may be biased downwards due to the adjustment of quality and of weights as well as due to the exclusion of asset prices and owner-occupied housing in inflation measurement (Israel & Schnabl, 2023).<sup>56</sup>

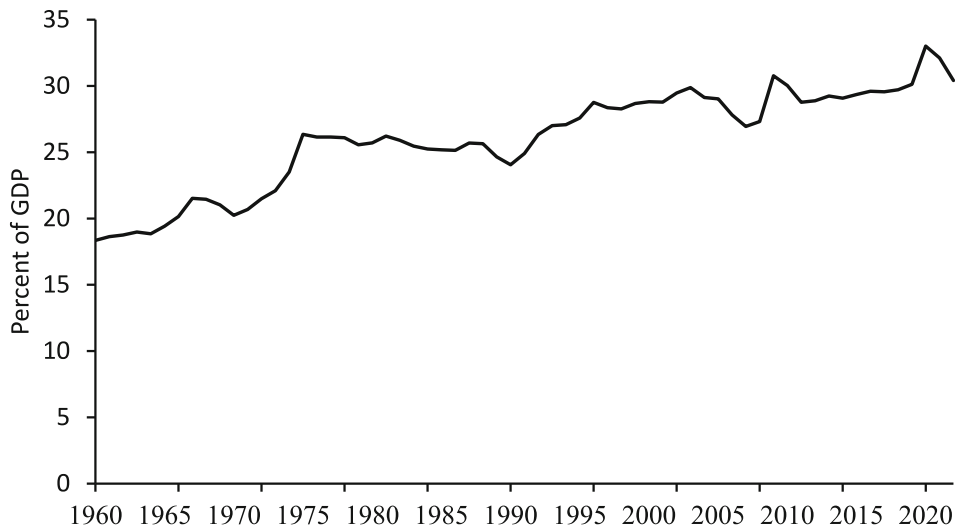
## 4.2 | Negative distribution effects and political stability

Alfred Müller-Armack (1956) had argued that the free market itself had social consequences, because it generated wealth and aligned the production structure with the preferences of consumers. As inflation has negative distribution effects at the cost of people with low incomes, he regarded price stability and competition as having positive social consequences. If the monetary policy of the ECB leads to inflation and real wage repression, the euro has unsocial consequences. Whereas in post-war West Germany a large middle class emerged, the erosion of the market order risks shrinking the middle class via the negative distribution effects of increasingly expansionary monetary, fiscal, and regulation policies.

<sup>55</sup>As regulation usually increases the costs of corporations, it is politically easier to implement, if financial compensation provided. Financial compensation was for a long time facilitated by monetary expansion.

<sup>56</sup>Perceived inflation as measured by the European Commission is much higher than officially measured inflation.





**FIGURE 7** Germany social security spending as percent of GDP. *Source:* Germany, Bundesministerium für Arbeit und Soziales.

The increasingly expansionary monetary policy has distribution effects because the government bond purchases of the central bank depress interest rates, while rising inflation devalues cash holdings and bank deposits. If the low-risk assets are over-proportionally held by the middle class and social security expenditure for the low-income class has been increasing both in nominal terms and a share of GDP (as shown in Figure 7), the burden is mostly born by the middle class. There is a redistribution from the middle- to the high-income classes, if the increasingly expansionary monetary policy drives up the prices of stocks and real estate, which tend to be over-proportionally held by high-income classes.<sup>57</sup> In contrast, interest rates on bank deposits that are in specific held by the middle class are depressed in nominal and real terms.<sup>58</sup>

This also involves a redistribution from the younger to the older generation, because assets are mostly held by the older generation. Young people have to work longer than earlier generations to build up wealth. This is even more the case, when declining productivity growth due to zombification depresses wages of young people when entering the labor market compared with previous generations. Social advancement has become difficult, and housing has become unaffordable. The concentration within the financial and the corporate sector implies growing income inequality, because the German middle class has been strongly intertwined with the small and medium banks and corporations.

The ECB has extended the scale of government expenditure by purchasing government bonds, depressing interest obligations, and increasing tax revenues by stimulating the business cycle. Recipients of social security contributions and people being employed in the public sector have profited from growing—central bank-backed—social security and related expenditure. Large corporations, which are well-organized in lobbying, could benefit at the cost of less organized business groups from subsidies.

Regulation can correct market failures (Bonbright, 1961) but can also generate rents by redirecting demand to politically influential groups (Posner, 1974; Stigler, 1971). Growing regulation more than proportionally increased the burden for the small and medium banks relative to large banks in an environment of depressed interest margins.

<sup>57</sup>As described by Cantillon (2010), if, for instance, newly issued money, is used to buy real estate or other assets, these assets can be bought still at a low price. If the newly issued money spreads around in the economy, the prices have already increased.

<sup>58</sup>Real deposit rates are strongly negative.

The same is the case for small corporations in comparison with large corporations, as in general, the administrative burden is more difficult to handle for small entities.

The distribution effects between the private and public sector as well as between banks and corporations of different sizes have come along with different regional growth dynamics. Regions, where the public administration is clustered, particularly in Berlin and the capitals of the Länder, have continued to grow. The regions with production sites of large corporations have exhibited growing wealth. In contrast, regions with only small and medium corporations have tended to suffer from weak economic activity. Young people have tended to migrate from remote regions with weak economic activity to administrative and economic centers with buoyant economic activity, mostly large and medium cities. Given low birth rates, the population in the countryside shrinks.

The upshot is that growing inequality of incomes and wealth has led to growing political dissatisfaction as reflected in the declining support for the leading parties CDU/CSU und SPD, formerly dubbed “Volksparteien” (people's parties).

## 5 | THE FUTURE OF PRIVATE PROPERTY AND POLITICAL STABILITY IN GERMANY AND EUROPE

With the rising potential for distribution conflicts, *private property* as embedded in the German Basic Law is put increasingly into question. Hiking real estate prices and rents have triggered demands to expropriate large housing corporations. The land transfer tax has risen. As the public spending obligations of the social security system have expanded fast, a substantial increase of inheritance and gift tax has been brought into discussion.

Negative interest rates, which were for many years charged by the ECB on the deposits of banks at the ECB and which were increasingly shifted by the commercial banks to the depositors, can be seen as an expropriation of banks and savers (Kirchhoff, 2021). They may come back, once the digital euro will be introduced, as envisaged by the ECB. While Germany ranks high among the OECD countries with respect to the burden of taxes and social security contributions, high inflation is added, which is missing democratic legitimization.

In the face of rising rents, rent controls can be seen—given rising interest rates and rising inflation—as creeping expropriation of landlords. In the face of the climate policy, the planned forced replacement of oil- and gas-based heating devices is seen as expropriation as well (Kirchhoff, 2023). Farmers complain about growing restrictions on land use linked to environmental policy.

This implies that as predicted by Eucken (1952), the erosion of price stability has come along with the erosion of all other constitutive principles of a market economy. Germany has ceased to be the growth engine of Europe, with welfare declining all over Europe due to the rising inflation. The political instability is growing.

Therefore, the recent monetary tightening of the ECB is an appropriate policy measure to reconstitute price stability and to reanimate growth. As inflation is caused not only by undue monetary expansion but also by fiscal expansion and proliferating regulation, the return to a low inflation environment in the EU would also necessitate a decisive reduction of government expenditure and comprehensive deregulation.

For such reforms, the 1948 currency and economic reforms of West Germany provide an important blueprint, both with respect to the implementation and the resulting benefits. As the necessary restructuring of the German economy would come along with a negative impact on growth in the short term, it constitutes a political challenge.

As structural reforms are likely to be even more difficult in a highly heterogeneous EU than in occupied post-war West Germany, future research should explore the ways how to implement reforms in the EU.

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## DATA AVAILABILITY STATEMENT

Data sharing is not applicable to this article as no datasets were generated or analyzed during the current study.

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