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## Labour surplus and capital shortage: German unemployment in the first decade after the currency reform

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# Kieler Arbeitspapiere

# Kiel Working Papers

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Working Paper No. 290

- Labour Surplus and Capital Shortage -  
German Unemployment in the First Decade  
after the Currency Reform\*

by

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German Unemployment in the First Decade  
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## 1. Introduction

In the post-war economic history of West Germany, there have been two periods of significant unemployment. If we take full employment to mean a jobless rate of less than 3 %, the two periods can be dated as 1948 to 1958 and 1975 to the present. While the latter period has naturally been subject to extensive economic research and a passionate policy debate, the earlier one has long since been left as a playground for historians with their legitimate emphasis on fact-gathering and hindsight interpretation. In this paper, we shall take an economist's look at this first period of unemployment, i.e. we do not present - as historians would do - a rich menu of figures and documents which could have a chance of adding up to a complete historical picture; we rather select a bunch of descriptive statistical measures and contemporaneous academic analyses which yield a plausible economic explanation of the causes of and the remedies for the unemployment problem of the time.

In detail, we proceed as follows. In Part 2, we give a brief quantitative outline of the level and the structure of West German unemployment in the fifties. In Part 3, we present the diagnosis of unemployment on which there was almost general agreement at the time and which still has much appeal today. While there was virtual consensus on the causes of unemployment, there was sharp disagreement on the remedies to be applied. In Part 4, we therefore present the most important paradigmatic views on economic policy as they appeared in the academic debate right at the time when unemployment reached its peak. In Part 5, we finally take a brief look at the path of economic policy which was actually pursued.

## 2. A Quantitative Profile of Unemployment in West Germany 1948-58

Table 1 shows the development of the West German unemployment rate in the first decade after the currency reform. In June 1948 the rate was 3.2 %, lower than in any subsequent year until 1958.

Table 1: Measures of Unemployment in West Germany

Year	Unemployment Rate* (p.c.)	Unemployed per Vacancy*
6/48	3.2	0.7
12/49	10.3	20.7
1950	10.2	13.3
1951	9.0	12.3
1952	8.4	12.0
1953	7.5	10.2
1954	7.0	8.8
1955	5.1	4.6
1956	4.0	3.5
1957	3.4	3.1
1958	3.5	3.2
1959-74	< 3.0	
1975	4.7	4.5
1980	3.8	2.9
1985	9.2	20.9

\*For 6/48 and 12/49 measured at the end of the month; for 1950-85 annual averages; from 6/48 to 1958 excluding, from 1975 to 1985 including Saarland and Berlin.

Source: own calculations with data from Bundesministerium für Arbeit (since 1953: Bundesanstalt für Arbeit), Jahreszahlen zur Arbeitsstatistik, various issues; Statistisches Bundesamt, Wirtschaft und Statistik, various issues.

Table 2: Measures of Interregional Dispersion of Unemployment

Year	Unemployment Rate across States				
	Mean* (p.c.)	Standard Deviation* (p.c.)	Coefficient of Variation	Maximum (p.c.)	Minimum (p.c.)
6/48	3.2	1.2	0.38	5.4	0.8
1950	10.2	5.9	0.58	25.2	4.3
1954	7.0	3.3	0.47	13.7	3.4
1958	3.5	1.6	0.46	6.3	1.7
1975	4.7	0.7	0.15	5.5	3.5
1980	3.8	0.9	0.24	5.3	2.3
1985	9.2	2.5	0.27	15.2	5.4

\*Calculated as weighted mean (weighted standard deviation) with the share of a state's labour force in West Germany as weight; from 6/48 to 1958 excluding, from 1975 to 1980 including Saarland and Berlin.

Calculations Source: own calculations with data from Bundesministerium für Arbeit (since 1953: Bundesanstalt für Arbeit), Jahreszahlen zur Arbeitsstatistik, various issues.

Within the eighteen months following the currency reform and the accompanying liberalisation measures, the rate jumped up to 10.3 % in December 1949. From its peak in the winter of 1949/1950 - actually reached in March 1950 at 12.2 % - the rate gradually declined to an annual average of 3.4 % in 1957 and - after a slight increase in 1958 - below 3 %, where it stayed until 1975. By most historical standards, this decline of unemployment was rapid and smooth although, within the trend, periods of accelerated decline (1950-51, 1952-53, 1954-56) and periods of decelerated decline (1951-52, 1953-54) can still be easily recognized. A similar picture emerges from the development of the ratio of unemployment per vacancy: extremely low at the time of the currency reform, it moved up to a peak in the winter of 1949/50 and later gradually declined until it reached a low in 1957. The ratio displays about the same pattern of accelerated and decelerated decline as the unemployment rate.

A casual glance at the labour statistics of the fifties reveals that, among all standard structural categories like region, occupation, age and sex, it is the region which dominates as a determinant of unemployment. Table 2 presents some simple measures of interregional dispersion of unemployment with data disaggregated by states. The coefficient of variation turns out to be much higher in 1950, 1954 and 1958 (above 0.45) than at more recent times (below 0.30), thus indicating that, relative to the level of unemployment, the regional differences were much more severe in the fifties than in the seventies or eighties; although a more pronounced regional component is reappearing in the most recent years - the coefficient of variation rises from 0.15 in 1975 to 0.27 in 1985 - it still does not reach the quantitative dimension of the fifties. Within the fifties, there was a tendency towards an equalisation of the unemployment rate - the coefficient of variation declines from 0.58 in 1950 to 0.46 in 1958 - with the brunt of the adjustment apparently falling into the first half of the period. The interstate range of the unemployment rate by and large supports these conjectures: in the fifties, the maximum state unemployment rate - the one of Schleswig-Holstein - moved down from

25.2 % in 1950 to 6.3 % in 1958, the lowest - the one of Baden-Württemberg - from 4.3 % in 1950 to 1.7 % in 1958 so that, in absolute and in relative terms, the range was markedly narrowing, albeit by no means to an insignificant level (as, for example, in 1975). It is striking that - even at the time of the unemployment peak in 1950 - the state of Baden-Württemberg came quite close to what may be regarded as full employment.

The regional disparity of the jobless rate in the fifties reflects the well-known fact that the unemployment of the time was closely linked to the problem of absorbing the refugees (or expellees) from Germany's eastern provinces. For simple geographical reasons, these refugees were cramped into the rural areas of the north-east (Schleswig-Holstein, Lower Saxony) and the south-east (Bavaria) of West Germany, with the share of refugees in the number of unemployed ranging in 1950 from 56.8 % in Schleswig-Holstein to 41.3 % in Lower Saxony and 39.3 % in Bavaria, significantly above the national average of 33.4 %. Table 3 shows that - parallel to the general decline of the unemployment rate and parallel to the reduction of regional disparities - the "refugee unemployment problem" lost its dramatic dimension and part of its peculiar regional component. The average share of refugees in the number of unemployed gradually declined from 33.4 % in 1950 to 26.3 % in 1954 and 22 % in 1958, which came close to a state of normality, with the refugees' share in unemployment only slightly surpassing their share in the population (about 18 %). In the same period, the coefficient of variation across states declined from 0.46 to 0.34, with the maximum share moving down from 56.8 % to 35.2 % and the minimum share rising from 2.4 % to 7.8 %.

How did this remarkably fast reduction and regional adjustment of unemployment in general and of the unemployed refugees in particular come about? As to the reduction, through an exceptionally rapid growth of overall employment which - in all the years from 1950 to 1957 - surpassed the growth of the labour force. As can be seen from Table 4, employment grew at an average annual rate of 4 % from 1950 to 1954 and of 3.7 % from 1954 to 1958, while the



Table 3: Share of Refugees in the Number of Unemployed and its Interregional Dispersion

Year	Share of Refugees in the Number of Unemployed across States				
	Mean* (p.c.)	Standard Deviation* (p.c.)	Coefficient of Variation	Maximum (p.c.)	Minimum (p.c.)
1950	33.4	15.5	0.46	56.8	2.4
1954	26.3	10.8	0.41	41.3	7.1
1958	22.0	7.4	0.34	35.2	7.8

\*Calculated as weighted mean (weighted standard deviation) with the share of a state's number of unemployed in the total number of unemployed in West Germany as weight; figures exclude Saarland and Berlin.

Source: own calculations with data from Bundesministerium für Arbeit (since 1953: Bundesanstalt für Arbeit), Jahreszahlen zur Arbeitsstatistik, various issues.

Table 4: Growth Rates of Labour Force and Employment and their Interregional Dispersion

Period	Average Annual Growth Rates across States				
	Mean* (p.c.)	Standard Deviation* (p.c.)	Coefficient of Variation	Maximum (p.c.)	Minimum (p.c.)
1950-54					
- Labour Force	3.1	2.0	0.65	4.9	-2.3
- Employment	4.0	1.2	0.30	5.2	1.2
1954-58					
- Labour Force	2.8	0.7	0.25	3.7	1.1
- Employment	3.7	0.3	0.08	5.3	3.2

\*Calculated as weighted mean (weighted standard deviation) with the share of a state's labour force (employment) in total labour force (total employment) in Germany 1950 (1954) as weight.

Source: own calculations with data from Bundesministerium für Arbeit (since 1953: Bundesanstalt für Arbeit), Jahreszahlen zur Arbeitsstatistik, various issues.

labour force grew at rates of 3.1 % and 2.8 % respectively. As to regional adjustment, the interstate variation of both growth rates gives some clue: from 1950 to 1954, the regional disparity of the average annual labour force growth rates - ranging from +4.9 % in North Rhine-Westfalia to -2.3 % in Schleswig-Holstein yielding a coefficient of variation of 0.65 - indicates a substantial reshuffling of the labour force away from the rural states to the industrial centers in North Rhine-Westfalia and Baden-Württemberg, where employment grew at average annual rates around 5 % compared to 1 % in Schleswig-Holstein and 2.6-2.7 % in Lower Saxony and Bavaria. This process of reshuffling labour slowed down significantly during the second half of the period, with the coefficient of variation of labour force growth declining to 0.25 and employment growth converging to rates between 3.5 % and 4 % p.a.

A somewhat more complete picture of interregional adjustment can be gained by examining the level and pattern of migration (Table 5). The migration quota - defined as the number of migration cases within West Germany as a percentage of the West German population - indicates that, all throughout the period 1950-58, the level of migration was higher than in recent years; within the fifties, the differences were small, with migration reaching its peak in 1953. Qualitatively the same conclusions emerge when looking separately at intrastate and interstate migration (columns 2 and 3).

A migration quota measures something like an aggregate propensity to migrate; it lumps together what may be called random and systematic interstate migration. Broadly speaking, random interstate migration may be defined as the part of migration which yields migration account balance between any state and the rest of the country, and systematic migration as the part which leads to positive or negative migration accounts. As to the movement of refugees from the rural areas to the industrial centers, it is systematic migration which concerns us here. Comparing the maximum and the minimum state quotas in any year indicates that this kind of systematic migration seems to have somewhat declined in the course

Table 5: Level and Interregional Dispersion of Migration

Year	Migration Quota (in p.c.)					
	(1) F.R.G. Total	(2) Intra -State	(3) Inter -State (gross)	(4) Inter -State (net)	(5) Max. State quota	(6) Min. State quota
1950	6.1	4.4	1.7	0.8	+3.1	-4.7
1951	6.3	4.6	1.8	0.6	+2.4	-3.2
1952	6.1	4.4	1.8	0.6	+2.0	-2.9
1953	6.5	4.6	1.9	0.6	+1.8	-3.9
1954	6.4	4.7	1.8	0.4	+1.6	-2.2
1955	6.4	4.7	1.7	0.4	+1.7	-1.7
1956	6.4	4.7	1.8	0.3	+2.0	-1.2
1957	6.4	4.5	1.9	0.2	+1.8	-1.0
1958	6.2	4.4	1.8	0.1	+0.8	-0.7
1975	4.8	3.5	1.3	0.1	+0.3	-0.7
1980	4.9	3.6	1.3	0.1	+0.4	-0.7
1984	4.2	3.2	1.0	0.1	+0.4	-0.6

(1) Number of intranational (i.e. intrastate plus interstate) migration cases as a percentage of the West German population

(2) Number of intrastate migration cases as a percentage of the West German population

(3) Defined as  $\sum M_i/P$ , with  $M_i$  being the number of immigration cases in state  $i$  and  $P$  being the size of the German population

(4) Defined as  $0.5 \cdot \sum |M_i - E_i|/P$ , with  $M_i - E_i$  being the balance of immigration ( $M_i$ ) and emigration ( $E_i$ ) cases in state  $i$  and  $P$  being the size of the West German population

(5) Defined as  $\text{Max} (M_i - E_i)/P_i$ , with  $M_i - E_i$  defined as in footnote 4 and  $P_i$  being the size of the population in state  $i$

(6) Defined as  $\text{Min} (M_i - E_i)/P_i$ , with  $M_i - E_i$  and  $P_i$  defined as in footnotes 4 and 5 respectively

Source: own calculations with data from Statistisches Bundesamt, Wirtschaft und Statistik; data for 1950-58 exclude, data for 1975-84 include Saarland and Berlin.

of the fifties. This conjecture finds support in the development of the net interstate migration quota, broadly speaking defined as the sum of all immigration balances (in absolute terms) divided by the population of the country. As can be seen from Table 5, this quota declines from 0.8 in 1950 to 0.1 in 1958, which is the level of later years. Hence, we may conclude that the fifties were a period of a comparatively high mobility and intense migration which gradually changed its character from being a systematic movement from the rural to the industrial states into a more random process. All this can be taken as evidence for a gradual equalization of economic conditions in post-war West Germany and for a fairly rapid integration of refugees.

As to the unemployed refugees, there was not only a regional, but also a significant occupational mismatch of labour supply and potential labour demand in the early fifties. Due to the pre-war predominance of agriculture and certain - mostly light - industries in the former eastern provinces of Germany, the refugees made up a disproportionately large chunk of unemployment among agricultural, forestry, glass, stone, ceramics and textile workers (in 1950 together about 45.1 %), far above the national average of 34.1 % in 1950. Again, the adjustment was fast: by 1958, the share had come down to 22.1 %, fairly close to the national average of 19.5 %. In a somewhat more comprehensive manner, this structural adjustment can be recognized in Table 6, which depicts various measures for the dispersion of the share of refugees in unemployment in 1950, 1954 and 1958 across 33 occupations. As the decline of the coefficient of variation from 1950 to 1958 indicates, there was a marked convergence towards the mean, with the adjustment being most pronounced in the first half of the period. Again, this can be taken as evidence for a high degree of mobility of the refugees, this time between occupations.

Besides the integration of the refugees and - closely connected to it - the temporary regional and occupational mismatch sketched above, there was no serious structural problem of the labour market in the fifties. With regard to sex, it is worth noting that

Table 6: Share of Refugees in the Number of Unemployed in 33 Occupational Groups\*

Year	Share of Refugees in the Number of Unemployed across Occupations				
	Mean** (p.c.)	Standard Deviation** (p.c.)	Coefficient of Variation	Maximum	Minimum
9/50	34.1	8.7	0.26	57.3	20.8
9/54	25.4	4.8	0.19	43.5	18.7
9/58	19.5	3.3	0.17	28.6	13.7

\*Measured at the end of the month

\*\*Calculated as weighted mean (weighted standard deviation) with the share of an occupation's number of unemployed in the total number of unemployed in West Germany as weight; figures exclude Saarland and Berlin

Source: own calculations with data from Bundesministerium für Arbeit (since 1953: Bundesanstalt für Arbeit), Jahreszahlen zur Arbeitsstatistik, various issues.

Table 7: Growth of Employment and its Dispersion across 32 Sectors

Period	Average Annual Growth Rate across Sectors				
	Mean* (p.c.)	Standard Deviation* (p.c.)	Coefficient of Variation	Maximum (p.c.)	Minimum (p.c.)
I: 6/46-6/48	+10.7	9.7	0.91	+46.1	- 6.8
II: 6/48-6/50	+ 6.5	9.9	1.52	+32.6	-20.5
III: 6/50-9/58	+ 4.2	3.9	0.93	+10.8	- 5.8

\*Calculated as weighted mean (weighted standard deviation) with the share of a sector's employment in total employment in West Germany at the beginning of period I (II, III) as weight

Source: own calculations with data from Bundesministerium für Arbeit (since 1953: Bundesanstalt für Arbeit), Jahreszahlen zur Arbeitsstatistik, various issues; Statistisches Bundesamt: Wirtschaft und Statistik, various issues.

all throughout the period 1950-58 women by far outpaced men in labour force growth (average annual rates of 4.6 % versus 2.2 %) and in employment growth (rates of 5.5 % versus 3.1 %). Apparently, many women started to supply labour pari passu with general economic conditions improving so that a considerable "quiet reserve" ("Stille Reserve") was gradually activated. As female employment growth lagged somewhat behind female labour force growth, the unemployment rate of women was most of the time slightly higher than the unemployment rate of men; except for one year (1955), however, the difference was never larger than one percentage point.

Table 7 rounds off the picture of the post-war German labour market up to 1958 by presenting the growth rates of sector specific employment in three sub-periods, namely the time before the currency reform (I), the time from the currency reform to the onset of the Korea boom which was also the period of peak unemployment (II), and the time during and after the Korea boom (III). At an average annual growth rate of 10.7 %, overall employment growth was spectacular in the first period, which is commonly looked upon as a time of somewhat chaotic economic development within an unsound monetary framework. Despite the marked rise in unemployment after the currency reform, the second period still exhibited a rapid growth of employment which was, however, outpaced by an even more rapid growth of the labour force. Employment growth in the third period came closer to normal dimensions, although, by most historical standards, it was extraordinarily fast.

While the level of employment grew fast, the sectoral structure of employment changed significantly in all three periods. The coefficient of variation of the growth rates across 32 sectors (including agriculture, mining, all industries and services) is slightly below one for the first and third period and even above one for the second period. Looking at the growth pattern of particular industries in the three periods, it becomes obvious that the structural shifts taking place before the currency reform were quite different from those in the two later periods: before the currency reform, the top winners in the growth race were mostly

consumer goods industries, like textiles and clothing, musical instruments, toys, and entertainment; in contrast, the picture of the second and the third periods is dominated by the overproportionate growth of investment goods industries, like iron and steel, metal manufacturing and vehicles as well as the growth of services. More technically, it can be shown that the ranking of the 32 sector growth rates in the first period hardly correlates at all with the ranking of either later period: Spearman's rank correlation coefficient ( $r$ ) turns out to be 0.16 for periods I and II, and 0.13 for periods I and III. In contrast, the correlation between the respective rankings of the two later periods is significant, albeit still far from perfect ( $r = 0.45$ ). These statistical measures indicate that the structural shifts before the currency reform may have been much more the product of chance and casual circumstances like the heavy control by the occupation authorities than of viable long-term market forces. Only the pronounced shift away from agriculture, which had negative growth rates all throughout, stands out as a common feature of all three periods.

### 3. The Cause of Unemployment

Among German economists of the early fifties, there was no real disagreement about the main cause of unemployment: a severe shortage of capital. In a somewhat modernized terminology, the average capital shortage story of the time may be told as follows.

Right after the war, Germany found herself with a good part of her capital destroyed or at least damaged through bombing raids and her population dramatically increased through the influx of refugees. Until the currency reform, this abrupt shift of factor endowments did not push up the jobless rate simply because industrial and agricultural employers could well afford to pay wages in an almost worthless currency. In the overcrowded rural states of the north- and southeast, many refugees began to work on farms, so as to secure a bare minimum of subsistence; most probably, their mar-

ginal product was extremely low - if not negative - so that employing them came close to being a charitable act of the farmers. As earning money had a low survival value compared to black-market activities, the work discipline was bad and absenteeism very common in the official (i.e., money wage) part of the economy. Hence, there was a hardly quantifiable, but certainly substantial hidden unemployment spread all across the country. All this changed with the currency reform, which swept away the monetary distortion from the employers' profit-maximising calculus, thus revealing the real extent of the capital gap: with fixed proportions of capital and labour prevailing in the short run and capital being the constraint, industrial firms had to lay off part of their labour force; similarly in agriculture, where the short run potential of substituting labour for capital had already been stretched to its physical limits. As agriculture had absorbed most of the refugees in the first place, the readjustment to normalized economic conditions quite naturally led to a marked regional disparity of unemployment between the rural and the industrial regions. With profits at a high and wages at a miserably low level, the only feasible medium run solution to the unemployment problem appeared to be a rapid and sustained growth of the capital stock combined with a movement of abundant labour away from the rural areas to the industrial centers where the marginal efficiency of capital was highest due to the enormous physical productivity of repair and modernisation investments in existing plants<sup>1)</sup>.

This story yields a very plausible explanation for the unemployment in the first post-war decade. It also finds considerable support in estimates of different types of unemployment which were carried out at various times between 1949 and 1954 (Table 8). The share of so-called structural unemployment was unambiguously esti-

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1. This kind of reasoning can be found in many academic publications on the matter, be they written by Keynesians or Ordoliberalists. See e.g. Arbeitsgemeinschaft ... (1950), pp.6f; Quante (1950), p.385; Wissenschaftlicher Beirat beim Bundesministerium für Wirtschaft, Reports of February 26, 1950, para 7-12 and, with some provisos concerning the almost exclusive preoccupation with capital shortage, Röpke (1950) pp.38ff.



Table 8: Estimates of Different Types of Unemployment

Type of Unemployment	year			
	12/49	2/50	6/52	9/54
a) in '000:				
business cycle	215	300	150	38
structural	785	800	600	429
seasonal	165	500	40	47
frictional	150	100	200	131
unspecified rest	245	300	250	178
total	1560	2000	1240	823
b) in p.c. of total (excluding seasonal):				
business cycle	15.4	20.0	12.5	4.9
structural	56.3	53.3	50.0	55.3
frictional	10.8	6.7	16.7	16.9
unspecified rest	17.5	20.0	20.8	22.9

Source: for 12/49: Ehret (1959), p. 103; for 2/50: Barnikel (1959), p. 70 based on Wagenführ (1950), p. 80; for 6/52: Bundesministerium für Arbeit (1952), Analyse der westdeutschen Arbeitslosigkeit, p. 13 (figure for seasonal unemployment calculated as residuum); for 9/54: Amtliche Nachrichten der Bundesanstalt für Arbeit, 2. Jg., Nr. 11 (vom 25.11.1954), p. 717.

mated to be above 50 %. Thereby, the term "structural" does not literally mean a mismatch between actual labour supply and actual labour demand with the effective constraint on employment being the mobility of the labour force between regions, sectors or occupations but rather a - mostly regional - mismatch of actual labour supply and a potential labour demand, which would be forthcoming if sufficient capital were available, with the effective constraint being not mobility, but capital shortage. Thus interpreted, structural unemployment is identical to capital shortage unemployment as defined above. The table further shows that, even at the peak of the unemployment problem in 1949/50, the business cycle share of unemployment did not exceed 20 %, thus remaining far below the share of structural unemployment.

Factor prices - notably the wage rate - played virtually no role in the contemporaneous diagnosis of unemployment<sup>2)</sup>. The wage level was simply considered to be extremely low, although, by international standards, it did not fare as badly as one might expect in a war-damaged economy: denoted in dollars at the official exchange rate, the average hourly wage of an industrial worker in 1950 was \$0.30 in Germany compared to \$1.45 in the United States, \$0.45 in the United Kingdom, \$0.23 in France and \$0.22 in Italy<sup>3)</sup>. Of course, such calculations must be taken with extreme caution since hefty exchange rate adjustments in the late forties (devaluations of the British pound and the French franc) may distort the picture; however, they do broadly indicate that there was at least no huge wage gap between West Germany and major continental countries. Still then, profits in general and retained earnings in particular were quite high in 1949/50, so that one may be justi-

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2. The remarkable exception is Röpke (1950), who mentions the wage level being out of line with marginal productivity as a possible explanation for at least some unemployment (p.45f). However, he does not elaborate on the point, and the main thrust of his argument falls within the sphere of capital shortage, including the problem of "structural adjustment" (p.44ff).

3. Own calculations on basis of data from "The Economist", Economic Statistics 1900-1983, Part III.

fied in discarding the wage level as a likely cause of unemployment at the beginning of the period (except, of course, in the trivial sense that there is always a general equilibrium wage at however low a level as long as the production function allows for some substitution of labour for capital). In later years, the situation was probably not much different (Table 9): in the period 1950-54, the wage level rose at around 7.5 % p.a., but this rise was more than matched by the combination of a labour productivity increase of about 6 % p.a. (at rapidly growing employment!), a rise of producer prices by almost 4 % p.a. and an improvement of the terms of trade by about 5.5 % p.a., so that, in efficiency terms, the pressure of labour costs is likely to have eased. This changed in the period 1954-58, when productivity growth, producer price inflation and the terms of trade improvement all slowed down while nominal wage pressure was held up at about the same annual growth rate as before. In that period, however, productivity growth was kept low precisely because employment was rising so rapidly, and one may conjecture that - at a given employment level - the productivity advance did suffice to more than compensate employers for wage rises; even if there still was a profit squeeze through wage demands, the numbers in Table 9 suggest that it did not reach dimensions which could have been a serious brake on employment expansion.

The capital shortage story neglected not only the wage level, but also the regional wage structure as a possible determinant of unemployment. This was analytically justified as long as the argument was intended to be short-run, with industry assumed to produce with a fixed coefficient technology at a given capital stock. Taking a longer run view, however, a wage differentiation in line with the regional extent of labour abundance may well have served as a means of facilitating the adjustment process by raising the marginal efficiency of capital in the overcrowded rural areas and thus attracting capital to these regions instead of merely relying on the movement of labour. Such a development program for the backward regions ("Notstandsgebiete") on the basis of regional factor price differentiation was apparently outside the realm of

Table 9: Average Annual Growth Rates of Industrial Wages, Prices, Labour Productivities and the Terms of Trade

	1950-54	1954-58
Wages (weekly)		
- male employee	+7.6	+6.1
- female employee	+7.6	+7.2
Wages (hourly)		
- male employee	+7.4	+8.0
- female employee	+7.2	+8.8
Output		
- per employee	+5.7	+3.1
- per worker	+5.9	+3.4
- per work hour	+5.9	+5.8
Producer Prices	+3.9	+1.8
Terms of Trade	+5.5	+2.2

Source: own calculations with data of Statistisches Bundesamt, Wirtschaft und Statistik, various issues; Bank for International Settlements, Germany - Monetary and Economic Situation 1950-1959, Basle 1959.

Table 10: Interregional Dispersion of Wages in Industry\*

Year	Wage Rate across States		
	Mean Wage per Hour (DM)**	Standard Deviation (DM)**	Coefficient of Variation
6/48	0.99	0.06	0.06
1950	1.28	0.07	0.05
1954	1.67	0.09	0.05
1958	2.34	0.20	0.09
1975	9.85	0.44	0.04
1980	13.41	0.59	0.04
1985	16.41	0.69	0.04

\*For 6/48 measured at the end of the month; for 1950-85 annual averages.

\*\*Calculated as weighted mean (weighted standard deviation) with the share of a state's industrial employment in West Germany as weight; from 6/48 to 1958 excluding, from 1975 to 1980 including Saarland and Berlin.

Source: own calculations with data from Statistisches Bundesamt, Wirtschaft und Statistik, various issues; Statistisches Jahrbuch, various issues.

academic discourse at the time<sup>4)</sup>. Nor did it materialize in practice, as the numbers in Table 10 indicate: the regional differentiation of effective wages in industry was small relative to the wage level, with the coefficients of variation being below 0.10. In this respect, the fifties were no different from more recent times.

To summarize, the diagnosis of capital shortage did, no doubt, focus on the most relevant aspect of German economic redevelopment at the time. By leaving wages out of the explanatory picture, it did not miss a major cause of unemployment; however, it may have obstructed the politicians' view to an alternative paradigm which might have been most fruitful in an economic policy debate about the sharing of the adjustment burden between capital and labour.

#### 4. The Cure for Unemployment

As mentioned above, the consensus on the cause of unemployment did not entail an agreement on cures to be applied. With rising unemployment in 1949, matters of full employment policy began to replace matters of liberalisation as priority items on the agenda of academic economists and policy makers. Up to the balance of payments crisis in the fall of 1950, unemployment remained the major topic of the policy debate. At no time later in the fifties did it reappear on the economic policy agenda with comparable vigour and urgency. Hence, not surprisingly, the most important statements of prominent economists about full employment policy were made at

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4. In its report of September 24, 1950, the Council of Academic Economists at the Ministry of Economic Affairs concludes its argument in favour of a rise in wages with the statement that a regional, sectoral and occupational differentiation of wages does, in fact, improve the employment opportunities for labour and the locational conditions for entrepreneurs (para 14, p.91). However, the point is made just once and not further elaborated. As the Council followed the practice of commenting its main points carefully and repeating them in quite a few reports, one may suspect that it was not a main point, but rather an off-hand remark of minor importance.

about the time of peak unemployment from, say, spring 1949 to fall 1950. No attempt will be made to summarize and evaluate the host of complementary and conflicting views put forward in numerous public speeches, memoranda and articles of the quality press. Instead, we shall pick out three paradigmatic positions which played a major part in the policy debate as particularly well argued cases based on different conceptions of the role of government, namely

- (a) the Keynesian position as presented by Erich Preiser and the working group of the German Economic Research Institutes, with Fritz Baade of the Institute of World Economics as its intellectual pace-maker;
- (b) the dogmatic liberal position as presented by Wilhelm Röpke;
- (c) the pragmatic liberal position as presented by the Advisory Council of Academic Economists ("Wissenschaftlicher Beirat") at the Ministry of Economic Affairs, with members including outspoken Keynesians: Erich Preiser, Karl Schiller and Otto Veit, as well as outspoken ordoliberalists: Franz Böhm, Walter Eucken, Leonhard Miksch and Alfred Müller-Armack.

In the following, these three positions will be briefly summarized, juxtaposed and evaluated to the extent that they had implications for the central policy question whether and how the capital shortage could be overcome by government action.

To (a): The Keynesian Position

German Keynesians usually pleaded for a combination of three measures: expansionary monetary policy, special tax incentives for saving and - to some extent - investment planning ("Investitionslenkung"). The macroeconomic part of their argument - as most cogently put forward by Preiser (1950)<sup>5)</sup> - ran as follows:

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5. Similar arguments were made by Quante (1950) and Schiller (1951) in a paper presented at the meeting of the "Verein für Socialpolitik" in Bad Pyrmont, October 1950.

Additional investment is needed to overcome the capital shortage. There are two ways of financing this investment at a given level of production and income: through an increase in current saving at the cost of current consumption - the classical way - or through money creation - the Keynesian way. The classical variant has the drawback that, be it through an increase of taxation or a rise of the interest rate, it entails a mere shift of aggregate demand away from consumption to investment, but no change of its level. As, in a state of unemployment equilibrium, production and income are determined by aggregate demand, there will be no change in income and hence no secondary effects on consumption and saving, in short: no self-perpetuating multiplier process which may move the economy closer to full employment. The capital shortage will only be reduced to the extent of the initial cut of consumption, no matter how this cut came about. Not so in the Keynesian variant: as the initial investment is financed through money creation, there will be no reduction of consumption either through higher taxation or through a rise of the interest rate. In unemployment equilibrium, income will rise by the amount of additional investment; thus an expansionary multiplier process is set in motion which leads to income induced increases in both saving and consumption. As the induced consumption demand meets a supply which is price inelastic in the short run, prices and - at given nominal wages - profits in the consumption goods industries will rise. If the process is now left to itself (without further monetary alimentation) the outcome will be that the original investment is eventually financed through an income induced rise in (voluntary) saving by private households and through a consumption induced rise of profits and thus retained earnings in the consumer goods industries. Hence, the multiplier process ends up financing itself, albeit at the cost of price inflation in the consumer goods industries. However, this cost can be avoided if the expansionary monetary policy is combined with the introduction of a system of tax incentives for saving which is precisely targeted at skimming off the consumer demand push resulting from the investment induced income expansion. Of course, such a policy cuts off all secondary effects of the multiplier process by preventing consumption to

rise with income so that the overall expansion just equals the original increase in investment, i.e. the investment multiplier equals one, a result which parallels the celebrated Haavelmo-Theorem of a unitary balanced budget multiplier. Only by starting another round of money financed investment can - and should - the expansionary effect be perpetuated. When looking upon an infinite sequence of such policy measures, the logical structure of this line of reasoning becomes evident: today's investment - pre-financed through money creation - is post-financed through tomorrow's income induced (and tax privileged, i.e. subsidized!) saving; with investment - temporarily financed through money creation - always running ahead of saving, the expansion is perpetuated.

The analytical difference between a Keynesian policy without and a Keynesian policy with tax privileges for saving is obvious: without the privileges, investment is at least partly post-financed through an (involuntary) inflation tax on consumers; with tax privileges, it is exclusively post-financed through voluntary (but note: subsidized) saving. As Preiser and other Keynesians emphasized, it was precisely this quality of raising voluntary saving ex-post and thus avoiding inflation which made this peculiar policy mix so attractive for West Germany at a time when the classical variant of saving through consumption restraint was neither effective nor feasible since the propensity to consume appeared to be extremely high, and the conventional Keynesian variant of forced saving carried with it the danger of initiating an inflationary spiral with all its negative consequences for external stability.

Apart from their macroeconomic argument for monetary expansion and tax reform, Keynesians made a strong welfare economic case for planning<sup>6)</sup>: major growth bottlenecks, above all in housing and transportation, could easily be recognized, but not easily be broken without government interference since the private rate of re-

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6. See e.g. Arbeitsgemeinschaft ... (1950), Ch.11 and, somewhat less dogmatically, Wissenschaftlicher Beirat beim Bundesministerium der Finanzen, Report of June 25, 1950, para 6.



turn in these bottleneck fields was apparently too low to attract a socially efficient amount of capital. In addition, the German capital market was extremely narrow so that the process of channelling business savings (profits) out of self-financing investment in own plant and equipment into socially efficient lines of production was seriously constrained anyway. Hence, extensive government intervention was required both in the shape of direct public investment to break bottlenecks, and in the shape of a tax reform aimed at promoting private investment in social bottleneck fields and improving the efficiency of capital markets by removing overdrawn tax privileges for self-financing.

To (b): The Dogmatic Liberal Position

Even among liberal economists, Wilhelm Röpke was alone in making a clear-cut case for higher interest rates as a necessary step towards overcoming the capital shortage (Röpke, 1950, Ch.8). His argument followed straight neoclassical lines. By definition, a capital shortage can only be overcome through saving, be it forced or voluntary. Variants of forced saving are outright taxation, open inflation, which raises business profits (retained earnings) at the cost of real wages, or suppressed inflation (through price controls) which leads to a quantitative rationing of consumption demand. While outright taxation might be justified in very narrow limits to finance public investments in carefully selected fields, the other two variants were simply unacceptable in a country like Germany, with its record of disastrous inflation and its more recent experience of central planning ("Bewirtschaftung"). Variants of voluntary saving include genuine household and business saving out of current income as well as capital imports. Extensive business saving through retained earnings had, in Röpke's view, the drawback of distorting the allocation of capital in a country like Germany, where the capital market was still in its infancy; hence, one should mostly rely on household savings and capital imports.

As to households, Röpke recognized a genuine conflict between their high time preference due to the long period of war and after-war misery and the economy's urgent need of capital to se-

cure full employment in the future. As the interest rate is basically the price of time - and not the price of liquidity - this conflict of the (perfectly legitimate) demands of the present and the future must be reconciled by a rise in the interest rate, even if the price to be paid were a less than maximum, but nevertheless intertemporarily optimal capital accumulation. Of course, a rise of the interest rate to its equilibrium, or in Wicksellian terms: to its natural level would necessarily reduce investment demand, but it was by no means clear that this would also reduce the volume of realized investment since, at a less than equilibrium rate, investment was supply constrained by saving, so that the level of realized investment might well increase along with the positively interest elastic supply of savings. Furthermore, the rise in the interest rate would lead to a readjustment of the investment structure towards the formation of capital with a particularly high marginal efficiency, i.e. - in Röpke's empirical judgement about 1950 Germany - those projects which satisfy demands in the near future at the cost of those aimed at more distant times.

To summarize, it was the interest rate which Röpke regarded as the main regulator of the intertemporal allocation of resources, and not some supposedly objective criteria of urgency which directs the decisions of some central planner. While Röpke was ready to grant that, at the given level of heavy regulation and price controls in certain capital markets (e.g. the housing market), a certain extent of corrective government intervention - including the provision of tax privileges - was probably warranted so as to secure enough new capital formation despite an artificially low market rate of return; even then, he emphasized that government intervention was only justified as a temporary emergency measure, to be called off as soon as free market pricing was reestablished which, at any rate, should happen as soon as possible. In this sense, Röpke was highly critical of (Keynesian) attempts at government planning to break apparent bottlenecks; instead, he strongly advocated the reestablishment of free and, as he assumed, efficient capital markets in all fields, no matter how "visible" and "urgent" the investment needs appeared to be.

In the same vein, Röpke argued in favour of substituting private foreign savings for official foreign aid, which was expected to be cut back anyway. In his view, only a steadfast policy of economic liberalisation was appropriate to regain the confidence of foreigners in German economic growth and thus allow the private capital inflow to increase and supplement domestic savings.

To (c): Pragmatic Liberal Position

If we interpret the Keynesian and the dogmatic liberal standpoints as opposite ends in a spectrum of opinions about the scope of government intervention in the economy of Germany in 1950, we would have to place the position of the Advisory Council of Academic Economists at the Ministry of Economic Affairs somewhere in the middle. In its main reports on unemployment, capital shortage and expansionary monetary policy (reports of May 8, 1949, February 26, 1950 and June 10, 1950), the council struck a delicate balance between Keynesian macro and neoclassical price theory.

In its statements on monetary and credit policy, the council by and large followed Keynesian-type analysis, albeit with a pronounced anti-inflationary undercurrent. In the report of May 8, 1949, the Council emphasized the need for moderate expansionary open market operations, which should be accompanied by an active market policy ("Marktpolitik") to cut down on monopolistic profit margins, which were considered to be at least partly responsible for too high a price level; increasing competition between industrial producers would drive up productivity, thus allowing wages and incomes to rise and, with appropriate tax incentives for household saving, this rise could be transformed into an increase of saving (not consumption).

Thirteen months later, in its report of June 10, 1950, the Council fully endorsed Preiser's concept of pre-financing investment through money creation. As a complement to the investment push, the Council recommended creating the conditions for a more efficient capital market. Unlike Röpke, however, the Council did not go as far as making a case for free and, thus, presumably high

interest rates; rather, it pleaded for tax incentives to saving and a systematic reduction of bond price risk through open market operations by the central bank ("Kurspflege") which, in plain language, boils down to a policy of pegging the interest rate, again a strongly Keynesian element.

In its main report on unemployment and capital shortage (February 26, 1950), the Council advocated credit expansion provided that - after pre-financing investment - the complementary goods would be forthcoming so as to avoid any inflationary pressure. The Council also recommended introducing tax privileges for special forms of saving ("Zwecksparen"), especially in the field of housing investment. In the same vein, it argued in favour of a general cut of individual and corporate income taxation, with tax savings being transformed into a compulsory loan ("Zwangsanleihe"), to be held in the form of bonds or stocks; thereby, firms should not be allowed to use their tax savings for additional self-finance except in very narrowly defined circumstances. With respect to direct labour market interventions, the report flatly rejected any kind of rationing of the labour supply, be it through compulsory short-time work, new public work programs ("Notstandsarbeit") or the prohibition of holding more than one job at a time. However, government support to refugees and other disadvantaged labour market groups was explicitly endorsed if the support was linked to active labour market adjustments of the recipients and not just granted as an unconditional rent.

To summarize, the major tune of the reports is a combination of moderate credit expansion to pre-finance investment with no Philipps-curve-type concession to inflation, of active tax policy to encourage capital formation and to channel savings into bottleneck fields, and of a social policy to facilitate labour market adjustment with no direct public work programs involved. The ideological picture of government which this tune conveys is that of a public authority which is in principle liberal minded, but which has at the same time the right and the duty to paternalistically impose distortions on the price system so as to secure an adequate

growth of the economy to the long-term benefit of all. It is a highly pragmatic version of economic liberalism, far from a socialist minded interventionism, but also far from any ideal of laissez-faire.

From a strictly welfare theoretic point of view, it is Röpke's dogmatic liberalism which, of the three positions sketched above, provides the most convincing answer to the question of how to overcome a serious capital shortage, namely through a rise in the price of time: the interest rate. All other variants of increasing saving entail at least some elements of coercion and distortion: in the case of tax privileges for saving, the taxpayers are forced to carry the burden of subsidizing (voluntary) saving; if the tax privilege depends on the type of saving (e.g., housing loans), an element of distortion is added. Of course, Keynesians and the Council of Academic Economists were well aware of this almost trivial point. It remains all the more striking that they did not feel obliged to give more than prima facie evidence of capital shortage to support their case and - even more importantly - to seriously consider the alternative of letting the interest rate adjust to the observed scarcities. Clearly, the welfare economic pillar of their argument was poorly developed; instead, somewhat cruder notions of maximising growth and capital accumulation prevailed.

As to macroeconomic theory, the essentially Keynesian line of reasoning as presented by Preiser and the Council of Academic Economists also had some serious analytical flaws: at no point did it clearly distinguish between the stock demand for money (hoarding) and the flow demand for savings, with, at given money supply, the former having a deflationary effect on aggregate demand and the latter having no effect at all as long as the velocity of money and, hence, the money demand remains constant. In their analysis, it is simply assumed that an increase in consumption demand does raise prices while an increase in saving (and thus investment demand) does not. In our view, it is the stock demand for money and the price elasticity of aggregate goods supply, not a trade-off

between saving and consumption, which eventually determine whether a monetary expansion leads into more real economic activity or more inflation. True, by expanding the aggregate production capacity of the economy, investment does - and consumption does not - increase future goods supply, but this is a medium- or long-run effect which may not prevent immediate inflationary pressures from emerging; at any rate, it is not discussed by the proponents of Preiser's concept of monetary expansion and income induced saving.

Politically, the pragmatic liberal and, to some extent, the Keynesian ideas did have distinctive advantages over Röpke's more radical line: they conveyed the picture of an active government which did not only recognize the capital shortage, but also did something about it. To let market forces run their merciless course without any substantial policy commitments by the public authorities might have overstretched the readiness of the population to adjust to economic conditions which were harsh enough anyway. Given this kind of political constraint on any conception of economic policy, the pragmatic position of the Council of Academic Economists at the Ministry of Economic Affairs deserves much credit as a remarkably liberal stance which made its most far-reaching compromises with less liberal policy conceptions precisely in that field where they were likely to hurt least: in the field of promoting capital formation for future growth.

##### 5. Economic Policy in 1949/50

Early in 1950, the public discussion about appropriate economic policies to reduce unemployment reached its political climax with the memorandum of the Allied High Commission which called for expansionary measures including a more aggressive monetary and credit policy<sup>7)</sup>. The West German government replied by restating its capital-shortage diagnosis of unemployment and listing all the

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7. See "Die Neue Zeitung" of February 20, 1950, No.43.

policy measures which the government had already undertaken or intended to undertake in the following months<sup>8)</sup>. Actually, there were three genuine public employment programs at the period of peak unemployment in 1949/50: a program to finance particular investment as well as export projects (volume: DM 0.3 billion) started in August 1949, a work-creation program (volume: DM 0.9 billion) and a housing program (volume: DM 2.6 billion), both initiated right after the "Memorandum War" between the Allied High Commission and the German government. In all these programs, a short-run expansionary effect was expected from a pre-financing commitment of the central bank. As a matter of fact, the extent of pre-financing of these three programs together remained well below DM 1 billion all throughout the year 1950, with the bulk of the more important work-creation and housing programs carried out in the fall of 1950 when the Korea-boom and the subsequent balance of payments crisis had set in; in any case, the programs did not amount to more than 3 % of aggregate gross investment in 1950<sup>9)</sup>.

Apart from the pre-financing schemes, the expansionary measures of the central bank in the years 1949 and 1950 were moderate by any conventional standard. In the second quarter of 1949, the discount rate was cut from 5 to 4 %, where it stayed until balance of payments considerations in the fall of 1950 led to a rise to 6 %. In addition, credit ceilings were lifted in March 1949, restrictions on the rediscounting of acceptances were removed in May 1949, and reserve requirements were reduced in July and September 1949<sup>10)</sup>. It is noteworthy that all these monetary measures were taken long before the High Commission issued its famous memorandum; hence, the only significant policy answer to the Allied warnings appears to be the initiation of the work-creation and the housing programs, no doubt a modest political yield which shows that, on balance, the German government was the winner of the memorandum war.

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8. See "Die Neue Zeitung" of March 6, 1950, No.55.

9. For the data, see Bank deutscher Länder (1950), p.27, Table 6 and Wallich (1955), p.156, Table 16.

10. See Wallich (1955), p.84f.

In summary, one can hardly escape the conclusion that the macro-economic policies of the German government and the central bank at the time of peak unemployment must have been very disappointing for all Keynesian economists who had called for more expansionary measures.

As described above, Keynesians and pragmatic liberals favoured tax incentives for saving, and virtually every economist made a case for a more efficient capital market to overcome the capital shortage. At the time of peak unemployment in the winter 1949/50, there already existed a long array of tax privileges for various forms of private capital formation which had all been introduced in the Tax Law Adjustment Acts of June 1948 and April 1949, so as to prevent the very high income tax rates fixed by the Allied authorities from stifling the work and saving motivation of the population. The privileges included accelerated depreciation allowances for capital expenditures incurred in repairing war-damaged equipment (para 7 (a) of the Income Tax Law), for new residential property (para 7 (b)) and for new industrial, commercial and agricultural plants (para 7 (e)), tax deductions for housing loans (para 7 (c)), shipbuilding loans (para 7 (d)) and special forms of saving, such as life insurance premiums and contributions to building societies (para 10). In 1950, the total amount deducted from individual and corporate income tax according to para 7 (a)-(e) of the Income Tax Law was about DM 0.9 billion, i.e. 4.2 % of the aggregate gross income of all individual and corporate tax returns; 48 % of this amount was due to para 7 (a), about 30 % to para 7 (c)<sup>11</sup>). These numbers suggest that the tax privileges had much importance for capital formation; however, as they were designed and implemented before unemployment reached its most threatening dimension (i.e. before mid-1949), they can hardly be regarded as a conscious political answer to the unemployment problem. Parallel to the cuts of marginal tax rates in later years,

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11. Own calculations on the basis of data from Statistisches Bundesamt, Einkommen- und Körperschaftsteuerstatistik 1950, pp.22, 35, 59, 66.



the privileges were even partly removed or restricted in applicability. Nor was there any speeded-up effort in 1950 to raise the efficiency of capital markets; in fact, a law with this explicit aim was passed as late as December 1952, when the unemployment problem had already lost a good deal of its acuteness.

All these facts convey the impression that the government did not really see the need for taking any exceptional steps to reduce unemployment. True, there were quite a few laws passed in 1949/50 which did have immediate relevance for the labour market, e.g. the resettlement orders of November 1949 demanding an organised resettlement of 300,000 refugees from Schleswig-Holstein, Lower Saxony and Bavaria to other states, the first housing law of April 1950, providing a legal framework for government intervention in the housing market, and the many laws on welfare matters. However, this legislation was based much more on medium- and long-term visions of economic growth and social equity than on short-term considerations of full employment. After the main economic switches had been shifted in 1948 and 1949 towards capital formation, the government was apparently ready to sit back and watch the capital stock growing. As far as mere numbers can prove anything, the rapid growth of gross capital formation between 1950 and 1958 at an average annual rate of 9.4 % (as compared, e.g., to 4.8 % in the United Kingdom and 5.9 % in France)<sup>12)</sup> and the parallel rapid decline of unemployment did prove this attitude to be justified.

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12. Own calculations based on data from "The Economist", Economic Statistics 1900-1983, Part III.

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