Dr. Loehr has written a monograph, entitled "The West German Banking System", covering the development of the financial institutions in western Germany since the end of World War II. It is one of the series of studies being published by the Historical Division, HICOG. Its distribution will be made in the near future. From material assembled for the monograph, Dr. Loehr, who is on leave from his position as associate professor of history at the University of Minnesota and was in 1943-45 history officer for the US Joint Chiefs of Staff, has written the following article for the Information Bulletin, reviewing one of the most vital phases in Germany's postwar monetary record.

Currency Reform after Four Years

A Review

by Dr. Rodney C. Loehr

Special Historian, Historical Division
Office of the Executive Secretary, HICOG

ONLY SEVEN years after the end of the war, the Deutsche mark is considered one of the "hard" currencies in the world today, and Germany's surpluses in the European Payments Union are almost an embarrassment.* Much of the credit for this spectacular recovery goes to German human and material resources and to the economic aid furnished by the United States, but the magic lamp that changed the situation overnight was the currency reform in the early summer of 1948.

When the nazi regime was overthrown, German finances were in staggering disordor. Germany's total national debt had shot up from 31 billion reichsmarks in March 1939 to 800 or 900 billion marks by April 1945. At the same time Germany's real wealth had fallen from 370 billion marks to about 250 billion, and production had dropped to approximately 30 percent of the 1936 level.

Of even greater immediate significance was the tremendous rise in the supply of money. During the decade 1935-1945 currency in actual circulation jumped from about 5 billion marks to 50 or 60 billion, and bank deposits climbed from 30 billion marks to somewhere between 150 and 240 billion. Thus, 200 to 300 billion reichsmarks were immediately available to buy a social product estimated at 35 billion reichsmarks in terms of 1945 prices.

The inflationary dangers involved in this situation were recognized by Allied and German experts. As early as November 1945, an American plan was placed before the Allied Control Authority, but it proved impossible to get Four Power approval for any currency reform program. Since under the Potsdam Agreement Germany was to be treated as an economic unit, and since a currency-reform program in one zone only would recognize the breakdown of Allied unity and suggest the partition of Germany, the Western Powers were reluctant to introduce a currency-reform program that would not cover the whole country. However, after the Soviet representatives walked out of the Allied Control Council in March 1948 and refused to participate in quadripartite rule, the way was cleared for tripartite currency reform.

Meanwhile, the situation in western Germany had not developed according to the pattern of past inflations. The Allies had kept price controls and strict rationing and had levied very high taxes in an effort to absorb excess purchasing power. Prices of rationed commodities remained stable for the portion that flowed through the legal market, but an increasing part of the social product entered the black market where barter became the normal method of exchange. Under a barter system money lost its meaning, and since each barter transac-

Definition of Terms

"Billion" as used in this article has the American meaning of "thousand-million" as different from the English and German meaning of "million-million" for the same word.

"Reichsmark was the monetary unit of Germany prior to the Occupation and continued in circulation until June 18, 1948. Its value was equal at par to 23.8 cents, as established by law in 1924, and later increased to 40.33 cents.

"Allied Military mark" was the paper currency introduced by the Occupation Forces at the end of the war for payments to Occupation personnel and purchases in Allied installations. For this purpose, it was replaced in mid-1946, i.e. the Military Payment Certificate for Americans.

*The EPU report for August showed the Federal Republic of Germany had a surplus of $37,000,000.
tion was unique, there was no price system in the black market. Because money was only of limited usefulness, there was little incentive for its accumulation.

The AVERAGE worker, for example, was better off if he worked only long enough to get funds to cover the purchases allotted by his ration card and then spent the rest of his time working in his garden, "scrounging" in the countryside or trading in the black market. The resulting absenteeism further reduced production.

The average businessman also had little incentive to produce for the legal market. Larger profits led only to higher taxes which in some cases mounted to more than 100 percent of annual income. Taxes on such a scale led to tax evasion, hoarding and barter. The businessman's incentive was to hoard raw material and workers and to keep his business alive for the day when money again had some meaning.

Hanging over all was the great mass of bank deposits, untouched by taxes and only partially blocked by controls. As long as these bank deposits could be drawn upon to feed hidden inflationary fires, no system of controls, rationing and income taxes could dispel the danger. Currency reform must cover not only actual currency in circulation but also the "over-hang" of bank deposits and the swollen government debts.

AFTER THE establishment of the Bank deutscher Laender (Bank of German States) and the withdrawal of the Soviet Union from the Allied Control Council in March 1948, the Western Powers were in a position to introduce the long-awaited currency reform. The original American proposal had envisaged an exchange of old reichsmark for new currency at a rate of 10 for 1, tax-reform measures and an equalization of war burdens. Only part of this plan was used, that dealing with currency conversion. A few elements from the German "Homburg" plan, which envisaged the blocking of bank accounts instead of currency conversion, were added to the American plan.

Under the plan that was finally adopted, all currency was converted and bank deposits were partially converted and partially blocked. An important matter was the conversion rate, since the rate would determine the amount by which currency and bank deposits were reduced. A rate of 10 percent had been planned, but after two grants of head money and the release of a fraction of the blocked accounts, it was decided to freeze the conversion at 65 percent. The reason for the revised rate was that, following currency conversion, a threat to internal financial stability developed which the original rate would have further encouraged. At the rate adopted, currency and bank deposits were reduced by 93.5 percent.

The effects of this drastic money deflation bordered on the miraculous. The reform had been introduced on a weekend in the middle of June 1948.* Economic deterioration stopped practically overnight, and production began to rise. Goods that had not been seen in the legal market for years were in shop windows within a few days. Money incentive reappeared, and the black market was dealt a severe blow.

But the effects were not uniform. People whose property had been in savings or money accounts saw their holdings nearly wiped out, but those whose property had been in goods or real estate were not touched. The aged, infirmed or sick who depended upon pensions, old people's homes or insurance policies were dealt a terrific blow. Businessmen now found themselves short of middle and long-term credit. Another difficulty was that currency reform maintained the relationship between prices and wages that had been frozen by the Nazis in 1936 and continued after the war.

*First public announcement was made in radio broadcasts and at press conferences at 6 p.m., Friday, June 18, effective Sunday, June 20.

Germans lined up in late June 1948 to get their first installment of DM 40 for old reichsmark: (left) in Berlin (right) in a Ruhr school house at Duisburg-Hamborn. (photos by US Army and Byers, JRIIA)
foreign markets prices had moved freely during those years. As a result, some German prices were too high and others were too low in relation to foreign prices.

Banks had likewise been hurt by the currency reform. Their liabilities in the form of deposits had been reduced, but the bulk of their assets, consisting of claims against the Nazi Reich, were lost. In order to provide banks with assets to balance against their deposit liabilities, "equalization claims" were created. These were claims against the states or the Federal Republic that could be transferred only under special circumstances and that bore three percent interest.

At first currency reform was not extended to Berlin which was still under Four Power control. However, efforts to reach agreement with the Soviet Union concerning currency reform for Berlin were unsuccessful. The Russians took the position that Berlin was economically part of the Soviet Zone and that they alone would issue and manage the currency for Berlin as a whole. To have endorsed such a proposition would have meant the loss of Berlin by the three Western Powers.

WHEN THE SOVIET authorities sought to include Berlin in their currency reform program, the Western Powers were forced to reject the Soviet claims and to proclaim a currency-reform program of their own in the week following currency reform in the western zones. The way was left open for a compromise with the Russians when it was provided that East marks would be accepted at par with Deutsche marks for certain specified purposes. Since East marks rapidly depreciated in value and yet had to be accepted at par, it became necessary to subsidize certain activities from the Berlin city budget. The existence of two legal currencies also caused bookkeeping difficulties for businessmen. This situation was ended in March 1949 when the Deutsche mark was made the sole legal tender for the western sectors of Berlin.

Currency reform in its technical features involved the substitution of a new kind of money for that already in circulation. The old paper money, whether reichsmark, rentenmark or Allied Military mark, no longer was legal tender, but only waste paper. Perhaps the most interesting of the technical problems was the value to be placed on the mark in relation to other currencies, particularly the dollar.

Since the new mark had not been defined in terms of gold or tied to a particular currency, it could not automatically be translated into other currencies. For some years following Germany's surrender, the reichsmark had had no fixed value and did not function as an international currency. Then in May 1948, just prior to currency reform, a 30-cent mark was established for imported foodstuffs. At the time of currency reform, the 30-cent rate was made the uniform conversion factor, although deviations were still authorized.

The 30-cent rate for the mark had been set after comparing German internal and world market prices. Prices of controlled items in Germany gave a 40- to 60-cent value to the mark. But uncontrolled prices could be adjusted to world prices, and it was considered that a 30-cent mark, although it would increase the price of foodstuffs, would give the best competitive rate for the mark.

BY SEPTEMBER 1948, rumors of coming European currency devaluations led to a study of the position of the mark if general devaluation should take place. If Germany maintained the value of its currency, its money would become more expensive in comparison with the devalued currencies and its export position would be weakened. If its currency was devalued to the same degree as others, it would keep its competitive position with these currencies and strengthen its competitive export position with non-devalued currencies. A devalued mark, however, would increase the internal German prices of commodities imported from non-devaluing countries. Since most of the food imports came from the dollar area, a devalued mark would either increase the price of food and the cost of living or involve subsidies, which in turn would raise taxes.

In solving this dilemma, the basic premise of the experts was that West Germany must achieve a very large increase in exports before the end of 1951, if its economy was to become viable. West Germany's greatest competitors were the West European industrial nations, and if these countries, particularly Great Britain, devalued their currencies, it was recommended that West Germany should devalue its currency by approximately the same amount.

On Sept. 18, 1949, Great Britain devalued sterling by 30.5 percent in terms of the dollar. Countries in the sterling area, including Denmark, Norway, Sweden and the Netherlands, quickly followed. Other continental
nations soon devalued their currencies, but by smaller percentages. France, which had a double-decker exchange rate, established a single rate that represented a devaluation of 22.2 percent. The problem for West Germany now was not the question of devaluation, but the amount that the mark was to be sliced. After study the Allied High Commission announced that it would not object if the Federal Government established a rate of 4.2 marks to the dollar, a devaluation of 20.6 percent.

Currency Reform was probably the most important single economic reform of the postwar period. All accounts agree that it arrested overnight the growing decay of the German economy. Its effects bordered on the miraculous. Before currency reform Germany was rapidly sinking into a barter economy and headed for the primitive standard of living that such an economy entails. With currency reform Germany regained overnight a modern exchange economy, with the ease of exchange of goods and services and the stimulation to production that a money economy represents.

Although the American share in currency reform was not a modest one, the reform was planned and executed through the cooperative action of the three Western Powers and the German authorities. There were two phases to currency reform: the decision to reform the currency, and the technical details of the conversion. The need for currency reform had been recognized immediately upon the start of the Occupation. But differences of opinion among the Four Powers and the impossibility of instituting the reform in the western zones alone without seeming to recognize a permanent split between East and West had delayed matters until the Russian withdrawal from the Control Council. Once the Russians had ended all pretense at Allied unity, it became possible for the Western Powers to initiate reforms without the hazard of a Russian veto. Even so, the decision to proceed with currency reform was a courageous act, for Russian reaction could not be wholly foreseen.

The principal technical problem of currency reform was the conversion rate to be chosen. In reality the conversion rate determined the percentage by which the money supply would be reduced. There were no exact standards of measurement that would automatically select the correct rate. The choice of rates was fundamentally a political decision, based upon the advice and judgement of the experts. It would be possible, of course, to argue that some other rate should have been chosen. But the real question is not whether the best possible rate was chosen, for no one can say with exactitude what the best possible rate was, but rather whether the rate chosen accomplished the desired result. Judged on this basis, currency reform was a spectacular success.

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The Legacy of Carl Schurz

Continued from page 8

...and scientists to devote their energies to rebuilding their homeland.

We are gathered here this morning to honor Carl Schurz' memory and achievements. He has left us a legacy of ideas and ideals. His deeds have won him immortality. It is proper that we should pause from our daily duties and count the blessings — as Germans and Americans — which we have been granted because this great man lived and because our two countries shared his genius.