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ECONOMIC CONDITIONS IN THE FEDERAL
REPUBLIC OF GERMANY

REPORT

PREPARED FOR THE
SUBCOMMITTEE ON EUROPE AND THE
MIDDLE EAST

OF THE

COMMITTEE ON INTERNATIONAL RELATIONS
U.S. HOUSE OF REPRESENTATIVES

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FOREWORD

HOUSE OF REPRESENTATIVES,
COMMITTEE ON INTERNATIONAL RELATIONS,
Washington, D.C., December 29, 1978.

This study was prepared by the Library of Congress at the request of the Subcommittee on Europe and the Middle East, chaired by Hon. Lee H. Hamilton, and has been submitted to the Committee on International Relations.

The work, which examines the economy of the Federal Republic of Germany and analyzes some of the implications for the United States of the emergence of West Germany as a major economic power, should be of benefit to members of the committee interested in the nature and management of our relationship with this important West European ally. The study complements a similar one prepared by the Library of Congress, entitled "Economic Conditions in Italy, France, and the United Kingdom" and published February 8, 1978, by the Committee on International Relations.

The findings of the study are those of the Foreign Affairs and National Defense Division, Congressional Research Service, Library of Congress, and do not necessarily reflect the views of the membership of the Committee on International Relations.

CLEMENT J. ZABLOCKI, *Chairman.*

(III)

FOREWORD

It is a pleasure to introduce this book to the reader. The book is a collection of papers presented at the International Conference on the History of Mathematics, held in the city of [illegible] in the year [illegible]. The papers are arranged in three parts: the first part contains the papers presented at the conference, the second part contains the papers presented at the [illegible] conference, and the third part contains the papers presented at the [illegible] conference. The book is a valuable contribution to the history of mathematics and is a must-read for all those interested in the subject.

LETTER OF TRANSMITTAL

HOUSE OF REPRESENTATIVES,
COMMITTEE ON INTERNATIONAL RELATIONS,
SUBCOMMITTEE ON EUROPE AND THE MIDDLE EAST,
Washington, D.C. December 29, 1978.

HON. CLEMENT J. ZABLOCKI,
*Chairman, Committee on International Relations,
House of Representatives, Washington, D.C.*

DEAR MR. CHAIRMAN: I enclose a study prepared for the Subcommittee on Europe and the Middle East by the Congressional Research Service of the Library of Congress.

This report examines the economic conditions in the Federal Republic of Germany. This study follows an earlier report on Italy, France, and the United Kingdom and thereby completes a broad look at the economies of four of our allies and the four largest members of the European Community.

West Germany, by its sheer economic strength and potential, has become a critical actor on the world scene. Its leadership role in Europe is uncontested. United States-West German relations have generally been excellent, although some policy differences exist. The willingness of both the United States and the Federal Republic of Germany, however, to cooperate in important policy areas such as military security and monetary affairs is a positive factor in enhancing the stability of the West.

This report was prepared by Edward T. Lampson, Specialist in European Affairs, Foreign Affairs and National Defense Division, Congressional Research Service, Library of Congress, and is being published in response to the renewed interest in Western European nations expressed by many Members of Congress and others concerned about the nature of our relations with our principal European allies.

The analysis presented here is that of the Congressional Research Service and does not necessarily represent the views of the members of the Subcommittee on Europe and the Middle East.

LEE H. HAMILTON, *Chairman,
Subcommittee on Europe and the Middle East.*

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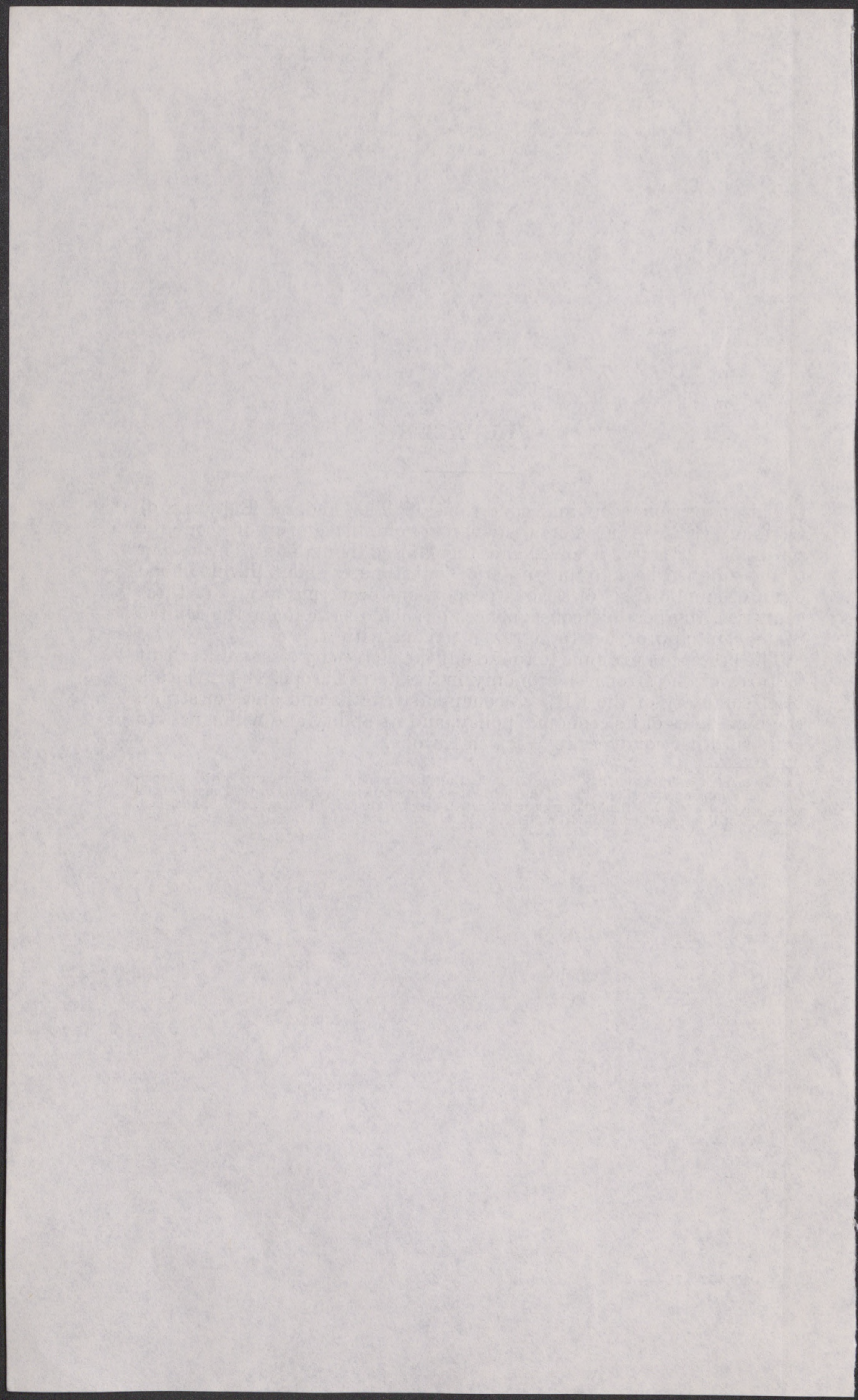
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PREFACE

This paper on economic conditions in The Federal Republic of Germany (FRG) is a sequel to an earlier committee print on economic conditions in Italy, France, and the United Kingdom.¹ The earlier report supplied background material for estimates about the likelihood of an economic crisis of serious proportions occurring in any of these countries, the possible consequences of such an event for the United States, and approaches to be taken to cope with it.

The present paper aims to round out the picture by discussing salient features of the strongest economy in Western Europe. It provides a brief summary of the FRG's economic strengths and areas of strain, the main lines of its economic policy, and its ability and willingness to support other countries in Western Europe.

¹ "Economic Conditions in Italy, France, and the United Kingdom," report prepared for the Subcommittee on Europe and the Middle East of the Committee on International Relations by the Foreign Affairs and National Defense Division, Congressional Research Service, Library of Congress, Feb. 8, 1978, U.S. Government Printing Office, Washington, 1978.



I. SUMMARY AND COMMENT

A. GENERAL OBSERVATIONS

The material presented in this report leads to the following observations:

(1) The West German economy is the strongest in Europe. Its efficient industrial plant, outstanding technical abilities, skilled labor force, comparatively harmonious industrial relations, and reputation for quality and prompt delivery have made its exports flourish. Even in bad times the demand for German goods has proved to be relatively inelastic. Its record of a trade surplus in every year since 1950 is unmatched in Europe and has resulted in building up the largest international reserves of any country in the Organization for Economic Cooperation and Development (OECD).

(2) A prudent and steady economic policy, designed with particular attention to maintaining the soundness of the German mark, has contributed to this constant growth of reserves. They now stand at over \$43 billion. In times of instability in the international exchange market, particularly when the chief reserve currency, the dollar, is falling, the German mark is an obvious refuge for foreign exchange traders. This factor has contributed to the appreciation of the mark against the dollar by more than 24 percent in the last 12 months—a fact which has created difficulties for German exporters.

(3) West Germany's economic strength gives it great influence both in Europe and overseas. For example, the German Government in 1974 contributed to the shoring up of the hard-pressed Italian Government by loaning it \$2 billion to build up its seriously depleted reserves. Again in 1976, when an Italian parliamentary election was taking place, the West German Central Bank loaned the Italian monetary authorities an additional \$500 million. West Germany likewise has played some part in encouraging the emergence of a democratic Portugal. It participated in 1975 and 1976 in EC loans to Portugal. In 1977 it lent the Portuguese Socialist-led coalition government \$200 million as a member of an international consortium. (The United States lent \$300 million.) Acting outside of Europe, the West German Government recently announced its intention to write off the debts of some of the poorest countries, as a number of other countries have also done.¹

(4) German international resources have also played an important part in the defense of the dollar. In January and March 1978 the German Central Bank increased its swap arrangements with U.S. financial institutions by \$4 billion. The principal concern of German officials regarding the depreciation of the dollar is the threat it represents to the stability of the entire financial system. However, German interests have also been directly affected by the dollar's decline. In the last year the market value in marks of the German Central Bank

¹ The West German Government is writing off the debts of 30 countries.

holdings of U.S. Treasury notes fell by \$7.9 billion. In view of these circumstances, the pressure applied by German officials for the reduction of oil imports and the improvement of the U.S. balance of payments will probably continue.

(5) Another example of German strength is its influence in international organizations such as the European Community (EC), the Organization for Economic Cooperation and Development (OECD), and the International Monetary Fund (IMF). The West German IMF quota is currently SDR 2.156 billion or 5.6 percent of the total. West Germany "represents one-third of the economic potential of the entire Community"² and is the largest contributor to the EC budget (37 percent) with an estimated 1978 assessment of approximately \$5 billion. It also made loans of more than \$500 million for EC medium-term monetary assistance programs in 1977.

(6) Among the EC's Big Four, West Germany is the strongest supporter of European integration. The advantages of membership in a flourishing West European economic and political organization are clear. A leading position in it would give great influence not only in Europe but throughout the world. West Germany will surely continue its strong support of the EC, including generous assistance to current and potential EC members in economic straits, as required, preferably in cooperation with international organizations and the United States.

(7) In these circumstances it is not surprising that the German Government is assuming a greater role in West European decision-making—a role which in the past it had avoided. An example is the German-French initiative taken at an EC Council meeting at Bremen in July 1978 for the establishment of an EC-wide system of closely coordinated European currencies (an enlargement of the so-called snake). The Germans proposed the scheme because they felt the need for greater monetary stability to restore business confidence in the West European area where roughly 65 to 70 percent of German exports are sold. The new plan may also prevent the German mark from becoming a reserve currency. An essential element of the project is the use of German assets as a major contribution to the European Monetary Fund which will be set up. In addition to this use of German assets there has been some talk—but no official confirmation—of plans for using some assets to finance a Marshall plan-type aid program to prepare Greece, Portugal, and Spain for entry into the EC.

(8) In the light of such developments it seems likely that the German Government will play an even larger role than it now does in the development of economic policy among the OECD countries as well as in the narrower membership of the EC, particularly if France, Britain, and Italy continue to face economic difficulties.

(9) The West German position of strength may be reasonably expected to continue for some time to come unless there are drastic political changes that currently seem unlikely. A change from the present SPD/FDP coalition to a government led by the CDU/CSU would not destroy the unusually broad consensus on economic and political policies which now exists among the German people. Should this consensus be lost, West Germany would face difficult socio-economic problems.

² Morgan, Roger, *West Germany's Foreign Policy Agenda*, Beverly Hills, 1978, p. 50.

(10) Despite its large international reserves and its highly productive and well-managed industrial system, the strongly export-oriented West Germany, like several other European countries, is more vulnerable to the effects of a worldwide recession than the United States, which depends primarily on an internal market. Dependence on foreign demand in the depressed conditions of the 1970's has slowed down West Germany's earlier rate of growth. The 1977 growth rate of 2.6 percent and the projected rate for 1978 of 2.5 to 3 percent are consistent with its record from 1971 through 1977, which averaged 2.7 percent. The average rate of growth for 1955-69 was 6 percent.

(11) West German leaders' fear of inflation limits what the West German Government is prepared to do to reflate the economy. This fear is reinforced by watching U.S. dollar inflation. (Generous German unemployment benefits make the Government's current cautious fiscal and monetary policy palatable to the trade unions.) Although West German concern about unemployment and inflation may seem exaggerated to outsiders, the parts played by these factors in German history, especially in the rise of Nazism, should not be overlooked.

(12) West Germany has firmly refused to stimulate its economy to the point where there would be a risk of serious inflation for the sake of pulling other European countries out of their economic doldrums. Another consideration in stimulating the economy through increased public spending is the constitutional provision that restricts Federal Government deficit spending to the level of capital outlays. The Government is also concerned that excessive public borrowing may "crowd out" private borrowers and increase interest rates. In addition to the inflation factor, German officials question the soundness of expecting too much from stimulative programs because of the high German propensity to save and the concomitant low consumption propensity. These characteristics tend to delay the effect of tax reduction and transfer payments upon domestic demand.

(13) The points outlined above illustrate how Germany's economic strength has endowed it with an increasingly impressive degree of international influence. Thus a harmonious relationship between the United States and the Federal Republic of Germany may be even more important in the future than in the past and more difficult to achieve. Hence it seems pertinent to summarize briefly some of the factors which may affect this relationship.

(14) The question arises whether increasing German influence in the EC will have detrimental implications for the United States. The U.S. Government has from the beginning supported the European Common Market but has never forgotten the possibility that the EC could adopt anti-U.S. positions. In the case of Germany, military dependence on the United States and a front-line position have, at least so far, ruled out any such self-centered behavior as exhibited by the French under General de Gaulle. The United States, however, in order to maintain this state of affairs, must conduct its relations with the EC and its individual members, especially West Germany, so as to prevent a repetition of the bad feeling which occurred in the 1971-74 period.

(15) In the future West Germany may find its interests in various fields—particularly economic matters—coinciding with those of its EC partners more than with the United States. A recent example was during the 1973-74 oil crisis when West Germany objected

strenuously to the use of German ports by the United States to ship military supplies to Israel during the Arab-Israeli War. West Germany's acute dependence on Arab oil made it line up with the other EC countries in opposition to the United States.

(16) German officials and industrialists hope to maintain the high level of German exports by replacing traditional uncompetitive exports like steel and textiles with high-technology products. An important step was taken in this direction in 1975 when the Brazilian and German Governments signed a contract estimated to be worth between \$6 billion and \$10 billion for the delivery of nuclear reactors and enrichment and reprocessing equipment. President Carter strongly opposed the deal on the ground that it involved an unacceptable risk of nuclear proliferation. The German Government is insisting on the complete fulfillment of the original terms of the contract but has made some concessions which the U.S. Government finds inadequate. The Nuclear Non-Proliferation Act of March 1978 provides for an embargo of uranium to countries exporting sensitive nuclear materials and equipment. Thus a failure to work out United States-German differences in the Brazilian case could result in a cessation of U.S. shipments of enriched uranium to Germany.

(17) Disagreements about how to handle human rights questions with the Soviet Government have arisen between President Carter and Chancellor Schmidt. The latter believes that quiet diplomacy provides the most effective way to assist the victims of Communist repression rather than resorts to highly publicized attacks on the Soviet Union for violations of the civil rights provisions of the Helsinki Accord. The Germans have made substantial progress in reuniting German families through their methods.

(18) Competition for the sale of military equipment in NATO, and especially the allocating of contracts for the standardization of NATO equipment, has caused conflicts of interest in the past between the Germans and the Americans; for example, the influence of the United States in blocking the selection of the German Leopard tank as the future standard NATO tank in favor of the U.S. XM-1 tank. Such competition is likely to continue.

(19) In order to keep our relations with West Germany on a good footing, care must be taken to avoid what may appear to the West Germans to be unilateral decisions taken because of our strategic superiority. One early example was the introduction in 1961 of the doctrine of flexible response as a key element in U.S. strategy, which was not accepted by NATO until 1967. A recent example is the question of whether to assign neutron bombs to the German front. After initial U.S. stress on the advantages of the bomb and over sizable domestic opposition, the Schmidt Government supported the stationing of neutron bombs in West Germany. The Government's position was then undercut when President Carter postponed indefinitely putting the bomb into full production. Failure to reach clear and definitive decisions in such cases is going to be even more damaging in the future than in the past.

(20) The West Germans have been concerned about the linkage between the mutual and balanced force reduction negotiations (MBFR) and the strategic arms limitation talks (SALT). They fear that the United States and the Soviet Union will negotiate bilaterally about

European theater nuclear weapons rather than in the multilateral MBFR negotiations where West Germany would be represented. This is because the next round of SALT negotiations will probably focus on so-called "gray areas" including MRBM's.³ They also fear that the United States may surrender the right to transfer cruise missiles to their NATO allies in return for Soviet concessions in the current negotiations. In general they are concerned about the possibility that restrictions on the use of nuclear weapons may leave Europeans without sufficient retaliatory force to neutralize Soviet medium-range nuclear weapons targeted on Western Europe.

(21) To sum up, the increasing influence of West Germany, although in some instances it may operate to oppose specific U.S. interests, on the whole promises to be used in the future, as it was to a remarkable degree in the past, to advance policies which the United States favors in the defense, political, and economic fields. To make the most of this fortunate situation, the United States must take care not to ignore German interests or appear to be attempting to dictate courses of action to the German Government. In particular, it is important to keep Germans fully informed and consulted about U.S. negotiations with the Soviet Union affecting German interests.

The points noted above should be considered against the background of West German economic developments since the war and current West German policies. These subjects are summarized in sections B and C of part 1. Recent German economic developments (1972-78), including the part played in United States-West German relations by the issues of dollar depreciation and German reflation policy, are discussed at greater length in part II. Part III provides background material with commentary. Part IV discusses institutional factors affecting the German economy. Part V contains a closing comment.

B. SUMMARY OF WEST GERMAN ECONOMIC DEVELOPMENT

The German currency reform of 1948 set the German economic revival in motion. In the early days it was fueled by Marshall plan and other foreign aid totaling \$4.5 billion. By the early 1950's a flourishing export trade was developing stimulated by a purposely undervalued German mark. The mark remained undervalued until the early 1970's. German characteristics of hard work and technical skills were reinforced by an ample supply of German expatriates from the East up to 1961 when the East German Government sealed off the German Democratic Republic from the West. Thereafter there was a massive influx of largely unskilled workers from southern Europe and the eastern Mediterranean. Unusually good relations between union leaders and industrial leaders, reflected in the early years in relatively low wages, and the high quality of German goods contributed to a booming export trade. The peak years of the "German miracle" were between 1950 and 1965. It was during these years that the present structural characteristics of the German economy were developed—an economy skewed more and more in the direction of exports. By 1977 one out of every four German workers was producing for exports.

Important economic consequences followed from domestic German political developments in the late 1950's and 1960's. In 1959 the Social Democratic Party (SDP), which traditionally advocated widespread

³ Medium range ballistic missiles.

nationalization, shifted to an acceptance of a free market economy with heavy emphasis on social programs. This prepared the way for the SDP to enter the German Government in 1966 and for the development of an unusually broad consensus on basic economic policy throughout the German population. As a result of the economic strains in 1966-77 the Government obtained legislative authority and developed administrative techniques for influencing economic events through Keynesian methods.

In the early 1970's developments took place which diminished some of the Federal Republic's earlier advantages in the world market.

As a result of the East German decision in 1961 to block emigration into Western Germany, the German skilled labor force tightened. A new generation of labor leaders was ready to take advantage of labor's improved bargaining position. As a result, German labor costs began to surpass levels in other industrial countries.

In 1967, 1971, and 1974-76 an unstable international economic situation forced many German exporters to absorb increased costs in order to maintain well-established trading channels. The concomitant reduction of profit margins was reflected in a decline of private investment and slower technological progress.

By 1972-74 West Germany was faced with the repercussions of a worldwide commodity price boom and of the quadrupled price increase of OPEC oil. During the mid-1970's the German Government succeeded in keeping inflation far lower than other European countries. In 1974 the German Consumer Price Index reached its peak at an annual rate of increase of 7 percent. By 1977 the rate was reduced to 3.5 percent and to 2.4 percent in July 1978. The appreciation of the German mark was a major factor in holding down the cost of imports, at least relatively.

The recession of 1974-76, however, hit the German economy hard. The drop in foreign demand for German goods brought German production to the point where the industrial plant was operating in the third quarter of 1977 at less than 82 percent of capacity (though still above the figures for Britain, France, and Italy). In 1975 the German real annual GNP growth rate dropped 2 percent. After a rise to 5.7 percent in 1976, it fell back to 2.6 percent in 1977. The growth rate for 1978 is currently estimated at about 2.5 to 3 percent. Unemployment has doubled since the early 1970's. Of the West German labor force 4.4 percent was unemployed in May 1978.

C. GERMAN ECONOMIC POLICY

A brief description of West German economic policies, especially those aimed at dealing with present economic problems, follows:

(1) UNEMPLOYMENT

Faced with an unemployment figure of more than a million, the German Government has encouraged the repatriation of as many as possible of its foreign workers, who numbered about 2.5 million in 1972; but only about 700,000 have actually left. Since November 1973 it has stopped issuing permits for the entry of new foreign workers. (This restriction does not apply to citizens of EC countries, notably the Italians.)

Some Government economic measures, especially Government investment programs and tax cuts, have been initiated to increase employment. Retraining programs are underway and the Minister of Economics is working on plans for developing new growth industries. Full unemployment payments last year and reduced benefits are available thereafter. But the determination to avoid a high rate of inflation puts a limit on what the Germans are willing to do to create jobs.

(2) GROWTH RATES

The German Government has been prepared to stimulate the economy, provided this does not seriously increase the rate of inflation. In 1975 the Government expanded its investment programs, increased transfer payments such as children's allowances for families with two or more children, lowered Bundesbank discount rates, increased investment incentives, et cetera. These programs were largely paid for by deficit financing. In 1976, when the economy grew by 5.7 percent, reflation planning was cut back. But the growth rate began to drop in early 1977 and in the spring the Government adopted a medium-term investment program providing for some \$13 billion in additional Government investment during 1977-81. In October 1977 the Germans passed a major tax cut. The growth rate for 1977 averaged only 2.75 and growth is expected to be only marginally higher in 1978. So another stimulation program of limited scope is being planned to take effect in 1979-80.

(3) DEVELOPMENT OF REFLATION POLICY

The degree of Government stimulation appropriate for the West German economy has been a source of bitter controversy in the past. The first Social Democratic Economics Minister, Karl Schiller, resigned in 1972 because the Cabinet overruled his insistence on dropping any reflationary measures which might involve higher inflation or deficit spending. The present Government is strongly opposed to measures which would significantly raise the inflation rate. German planners operate within clearcut limits. Article 115 of the German Constitution authorizes Government borrowing as a rule "only for expenditures for productive purposes and only on the basis of a federal law."⁴ Public borrowing is also kept down so as not to squeeze private borrowers out of the capital market. The present plans for economic stimulation are not to exceed about \$30 billion or roughly 4.75 percent of GNP. In general it is the German Government's position that current economic problems cannot be solved by quick fixes but require more substantial treatment. They plan public investment programs and other fiscal measures to develop advanced growth industries and retraining programs to equip labor to enter new types of jobs.

(4) OUTSIDE PRESSURES FOR REFLATION

In the recent past the United States and other OECD members have urged the Federal Republic to reflate more than the latter has been willing to do. In 1977 and 1978 the OECD Secretariat and leading

⁴ Peaslee, Amos J., *Constitutions of Nations*, 2d ed., 1956, vol. ii, p. 53. In recent parliamentary debates it has been argued that "the continuing excess of net lending [to deal with the excess labor supply] over fixed investment is unconstitutional." OECD Surveys Germany, June 1978, p. 43.

member states urged an increase of the German growth rate up to 5 percent from the 3.5 percent forecast for 1978. Some U.S. experts believed this could be done without inflation because of the amount of unused capacity in the German industrial system and because the German labor market was slack with more than a million out of work. Pursuant to its commitment at the Bonn Economic Summit Meeting in July 1978 the German Government has agreed to a limited amount of reflation. It has proposed tax cuts and related measures equivalent to 1 percent of German GNP. These measures should become effective on January 1, 1979, and January 1, 1980.

(5) APPRECIATION OF CURRENCY

Up to the end of 1971 the German mark was greatly undervalued. Since then it has been revalued a number of times. Since 1973 the mark has floated freely. Recently the German Government has been concerned about the appreciation of the mark which has created difficulties for German exporters. Between May 1977 and May 1978 the mark has appreciated by more than 20 percent. There is a close connection between the appreciation of the mark and the depreciation of the dollar. Thus German moves to come to the defense of the dollar in the international exchange market and by increasing its credit line to the U.S. Treasury and the Federal Reserve are related to their concern for the mark. So may the recent initiative of the German and French Governments to establish a new European monetary system.

(6) EC MEMBERSHIP

Looking upon membership in a European supranational organization as one way to resolve the problems and nightmares of recent German history, the West Germans have been strong supporters of the EC from the beginning. Although the original enthusiasm has cooled somewhat, among the EC's big four the Germans are the most deeply committed. If the German initiative for establishing a European monetary system is successful, it should be a big step toward fuller integration which has been stalled for the last 5 or 6 years.

As members of the EC, the Germans try to apply their free trade principles to the greatest extent possible. But they are unlikely to succeed in dismantling the protective features of the market against outside competition as much as they wish because other EC members, particularly the French and the British, are determined to keep them. And in the case of the common agricultural policy, German farmers will support the continued protection of agriculture.

(7) THE COMMUNIST STATES

Especially since the recession in the West, the West Germans have been eager to improve their commercial relations with the Communist bloc. This was a natural part of Chancellor Brandt's Ostpolitik by which the West Germans hoped to reduce tensions and improve prospects for their relationships, at least on a humanitarian level, with the Germans in the German Democratic Republic. In 1973-74, West German trade with the Soviet bloc plus Communist China rose by 39 percent. German exports have been heavily financed by German loans which have been primarily extended by private creditors.

Between 1972 and 1976, Communist indebtedness has more than doubled. Eastern countries are trying to reduce this indebtedness by increasing exports and slowing imports. Contrary to expectation, the Soviet Union has not been able to balance its accounts by supplying West Germany with oil, natural gas, or electric power in any significant amounts.⁵ Despite the rapid growth in trade with the Communist countries, this trade accounted in 1977 for only 6.1 percent of total German exports.⁶

(8) THE THIRD WORLD

The West Germans are greatly interested in improving economic relations with the Third World. Although West Germans had no ex-colonies with which they had special relations, like the British, the French, and the Dutch, they are well aware of the importance of less developed countries as sources of raw materials and potential markets for German exports. They have been active participants in the Development Assistance Committee (DAC) of the OECD. Recently, they have stepped up their aid to strategically placed countries in Africa such as Zambia and Zaire.

In connection with the international discussion over what kind of a new economic policy can best take account of the requirements of less developed countries, the Germans have taken part in meetings of UNCTAD and the French-initiated Conference on International Economic Cooperation (CIEC). In general, the Germans have upheld the free trade principles which have guided German trade policy from the beginning of the Bundesrepublik.

They have generally looked with disfavor on plans for controlled markets and thus have opposed the UNCTAD Common Fund proposal to finance the stabilization of price levels of selected commodities. In their view, the provision of large buffer stocks of primary commodities would be costly and would distort the operation of world market forces.⁷

(9) TRADE

Export trade remains central to German economic development. Despite a decline in foreign demand since 1974 and a consequent slowdown of the economy, Germany has been able to maintain a surplus trade balance. As in the past, demand for German goods has been relatively inelastic. However, the nature of German goods is beginning to change. Older industries such as steel, textiles, and mass-produced machine tools are finding it increasingly difficult to stand up to the competition from factories in countries with low labor costs. Forward-looking producers are specializing on newly designed motor vehicles, advanced electrical equipment, chemicals, optical and precision mechanical products, and machinery—goods which form the bulk of German exports to the United States.

German exports to the United States amounted to \$7.215 billion in 1977. (Between January and July 1978, exports to the United States rose by 18 percent.) German imports from the United States came to \$5.982 billion, leaving a U.S. deficit in this bilateral trade in 1977 of \$1.233 billion. The main German exports to the United States

⁵ Morgan, *op. cit.*, pp. 23-24.

⁶ OECD Statistics of Foreign Trade, July 1978, p. 72.

⁷ Morgan, *op. cit.*, pp. 58-69.

in 1977 in millions of dollars were motor vehicles (2,975), machinery (1,445), chemicals (971), electrical equipment (382), optical and precision mechanical products (263). The main German imports from the United States were machinery (1,053), chemicals (1,006), edible fats and oils (844), electrical equipment (749), grains (500), and aircraft (411).⁸

Profiting from an expanding import market, U.S. sales in 1977 of finished manufactures exported to Germany amounted to \$4 billion, an increase of 15 percent over the previous year.

Sales should be higher in 1978 because the decline of the dollar has given U.S. goods a competitive edge not only in Germany but also in third markets where Germany has a significant share of the market.⁹ There are no major commercial issues outstanding between West Germany and the United States.

The chief sales area for Germany is Western Europe where German exporters sold just under 65 percent of their total exports in 1977. Other areas can be divided into roughly equal groups as follows: The United States (6.67 percent), Communist countries (6.12 percent), the Middle East (6.12 percent), Africa (4.80 percent), Latin America (3.48), the Far East (2.60 percent), and Japan (2.37).

In terms of trade policy, the German Government still adheres to the free market principles which were applied by the Adenauer government. As a member of the EC, West Germany is bound by the tariff arrangements agreed to within that organization, but it exerts pressure in the direction of freer trade.

⁸ OECD Statistics of Foreign Trade, July 1978, pp. 72-73.

⁹ American Embassy, Bonn, Foreign Economic Trends and Their Implications for the United States, May 1978, pp. 9-11.

II. THE RECENT ECONOMIC PAST, 1972-77

A. THE COMMODITY PRICE BOOM AND CONTINUING INFLATION

Of all the countries of Western Europe, the Federal German Republic has been the most successful in holding down the inflationary pressures created by the commodity price boom of 1972-74, the 1973-74 OPEC oil price increase, and the ensuing 1974-76 recession.

Despite its economic strength, the Federal Republic was far from immune to the consequences of external price increases. Imports of food, raw materials, fuels, and semiprocessed manufactures, all essential to the domestic economy, accounted for 56 percent of German imports. Thus, the steep rise in the prices of primary commodities contributed to domestic inflationary pressures already generated by rapid wage increases. As a result, the German Consumer Price Index, which had shown an annual increase of above 3.5 percent only once between 1955 and 1970, rose swiftly. In 1974 it reached the high point of 7 percent. This was a relatively low figure compared to increases two or three times as large in other major European countries, but it was considered dangerously high in Germany.

Increases in German consumer prices and industrial wages between 1972 and 1977 as compared to the situations in Italy, France, the United Kingdom, and the United States are shown in the following tables.

TABLE II-1.—CONSUMER PRICES¹

[1971=100]

	1971	1972	1973	1974	1975	1976	1977
Germany.....	100	105.5	112.8	120.7	127.9	133.7	138.6
Italy.....	100	105.7	117.1	139.5	163.2	190.6	225.3
France.....	100	105.9	113.6	129.2	143.4	157.2	172.1
United Kingdom.....	100	107.1	117.0	135.7	168.5	196.3	224.0
United States.....	100	103.3	109.7	121.8	132.9	140.6	149.7

¹ Adapted from table 18, OECD Economic Outlook, vols. 20-22.

TABLE II-2.—HOURLY EARNINGS IN MANUFACTURING¹

[Percentage changes]

	1972	1973	1974	1975	1976	1977
Germany.....	8.7	10.7	10.6	8.2	6.5	7.0
Italy.....	10.4	24.3	22.4	24.0	21.1	26.0
France.....	11.3	12.4	18.6	15.0	14.7	12.0
United Kingdom.....	12.8	12.6	17.0	14.0	16.6	10.0
United States.....	6.7	6.8	8.4	8.0	7.9	8.0

¹ Table 16, OECD Economic Outlook, vols. 20 and 22.

It should be noted that in the case of Germany the increase in wages exceeded the increase in the cost of living by a smaller amount than in the other three countries.

German success in reducing the inflation rate can be attributed to restraint in wage negotiations, the reduced prices of imports because of the steady appreciation of the German mark, and firm fiscal and monetary policies which restricted the economy in 1972-73 and then reflatd somewhat in 1974 in the face of the recession of that year.

B. THE 1973-74 OPEC OIL PRICE INCREASE

The quadrupling of OPEC oil prices increased German expenditures on imported oil from \$5.9 billion in 1973 to \$12.5 billion in the following year. (Germany produced only about 5 percent of its oil requirements domestically and was dependent on imports for about 57 percent of its total energy requirements.) Unlike most other European countries, however, the Federal Republic ended the year with a trade surplus of over \$15 billion. Late in 1974 the Federal Ministry of Economics stated that "the Federal Republic is not likely to suffer from the balance of payments difficulties in the foreseeable future that result from higher oil prices."¹ The subsequent German record bore out his prediction, as in the following years Germany maintained a continuous overall trade surplus.

Thus the German economy was not thrown off balance by oil price increases to the extent of the other major European trading countries. But West German trade with OPEC countries was in surplus in 1977 for the first time since 1973.² (This was partly because of rising imports of North Sea oil.)

C. THE RECESSION OF 1974-75

The world inflation in commodity prices indirectly forced the German economy into its most severe postwar recession. In 1972-73 inflationary demand pressures in other industrialized Western countries had created a German export boom. But the increase in oil prices in 1974 generated strong deflationary pressures on aggregate international demand, especially in OECD countries which accounted for over 70 percent of the sale of German exports.³ Sales of German basic and investment goods plunged, as did consumer goods to a lesser degree. As a result, German GNP increased at an annual rate of only 0.4 percent in 1974.

Reacting to the severe drop in foreign and domestic aggregate demand and sharply reduced domestic production, in 1975 German GNP registered its poorest performance since 1948; it declined by 2 percent. Concurrently, German unemployment rose to 1.02 million, double the figure for the preceding year. Furthermore, in the face of the appreciation of the German mark and rising labor costs, German exporters cut profit margins in order to keep export prices competitive. As a consequence, domestic investment suffered.

As is shown by some statistical comparisons, the Federal Republic's GNP performance followed roughly the same pattern as did its major Western partners in the OECD (with the exception of the United Kingdom) but Germany had a considerably lower level of unemployment.

¹ The Federal Minister for Economics, 1st Revision of the Energy Programme of the Federal Government of Germany, Bonn, Germany, November 1974, p. 8.

² Monthly Report of the German Bundesbank for February 1978, p. 39.

³ OECD Economic Surveys Germany, June 1978, p. 20.

The following table illustrates the differences in the rates of economic growth in West Germany, Italy, France, the United Kingdom, and the United States for this period.

TABLE II-3.—GROWTH OF REAL GROSS NATIONAL PRODUCT¹

[Percent change from year to year; constant dollars]

	1972	1973	1974	1975	1976	1977
Germany.....	3.0	5.3	0.4	-2	5.7	2.75
Italy.....	3.4	6.3	3.4	-2.75	5.6	2
France.....	5.5	6.5	3.9	1	5.2	3
United Kingdom.....	3.5	5.2	-2	.5	2.1	.25
United States.....	6.1	5.9	-2.1	-3.75	6.0	4.75

¹ OECD Economic Outlook, vols. 18, 20, 22, table 1.

A table comparing unemployment rates shows that unemployment in West Germany, although viewed seriously by the German Government, was considerably lower than the figures for Italy, the United Kingdom, and the United States. The exodus of 700,000 foreign workers from West Germany in 1974 eased the situation somewhat and the practice of many German employers of shortening the work-time of their employees helped to reduce the number who were thrown out of work.

TABLE II-4.—UNEMPLOYMENT RATES¹

[Percent of total labor force unemployed]

	1973	1974	1975	1976	1977
Germany.....	0.9	1.5	3.6	3.6	3.5
Italy.....	3.7	3.1	6.4	6.4	7.2
France.....	2.6	2.7	4.1	4.6	5.2
United Kingdom.....	2.8	2.9	5.1	7.0	7.5
United States.....	4.9	5.4	8.3	7.5	7.0

¹ OECD Economic Outlook, vols. 18-20, 22, tables 7 and 8. All figures except for the United States have been adjusted to international definitions by the OECD.

The German Government acted quickly to improve the economic situation without driving up inflation. In 1972-73, the Government had introduced some restrictive measures to restrain inflationary forces, but these restraints were replaced in 1974 by a series of stimulative measures, including a 7½-percent investment grant, a comprehensive fiscal reform package, a DM5.75 billion program to stimulate construction, and a DM10 billion program for income transfers. Last, a tax bill was introduced in 1975 to provide for additional tax rebates.⁴

This vigorous Government policy contributed to an unexpectedly strong upswing of the economy in early 1976, supported later in the year by buoyant exports. GNP growth averaged out at 5.7 percent. In 1977, the recovery slackened, falling to an annual growth rate of 2.75 percent. On the inflation front, West Germany, however, made a good showing. Helped by an appreciating mark and a slowing economy, the Consumer Price Index dropped from 4.5 percent in 1976 to 3.7 percent in 1977,⁵ and then to an annual rate of 2.4 percent in July 1978.

⁴ OECD Economic Surveys, Germany, May 1976, pp. 19-20.⁵ Ibid., pp. 33-46.

D. THE GERMAN INTERNATIONAL FINANCIAL POSITION

According to the October 1978 issue of *International Financial Statistics*, West German international reserves at the end of March 1978 amounted to \$43 billion as compared to \$29.7 billion for Japan and \$19.41 billion for the United States.⁶ Consistently large balance-of-payments surpluses and the flight of capital into the German mark, precipitated by the steep decline of the dollar in 1977 and 1978, account for an almost \$10 billion increase in the German reserves in the last 3 years.

The Bundesbank has kept the major part of this amount invested in U.S. Treasury bills and medium-term Treasury notes—roughly \$32.5 billion as of July 1978.⁷ As a result of these investments, the rapid depreciation of the dollar in the last year involved large-scale losses for the German Government, amounting to roughly \$7.9 billion.

Although on a rather limited scale when compared to the size of total reserves, the Bundesbank as of July 1978 had loans outstanding to the rest of the world amounting to DM5,380 million. Of this amount DM519 million consists of loans in connection with EC medium-term monetary assistance, DM1,884 million of claims arising from foreign exchange offset agreements with the United States and the United Kingdom, DM477 million of other loans to foreign monetary authorities, and DM2,501 million of loans to the World Bank.⁸

E. THE DECLINE OF THE DOLLAR AND UNITED STATES-WEST GERMAN RELATIONS

From 1960 to 1977, the American dollar lost more than half its value in terms of German marks. In calendar year 1977 alone the German mark appreciated against the dollar by 10.8 percent. The dollar's rate of decline increased precipitously in the last 4 months of the year.

The Carter administration made no moves until December 1977 to intervene in the market to stabilize the dollar. The administration expressed the view that the dollar's weakness merely reflected the big U.S. trade deficit of about \$31 billion in 1977 caused by large U.S. oil imports and the relatively slow economic growth in Japan, Germany, and other countries.⁹

For many months Europeans were distressed by what they considered American inaction. Indeed, some criticized Secretary of the Treasury Blumenthal for "talking the dollar down" deliberately in order to make American goods more competitive in world markets. German officials from Chancellor Schmidt down urged the United States to initiate an effective policy to reduce oil imports as soon as possible. Without such a program, they feared for the stability of the whole international financial system. Their concern increased as the dollar declined by 9.2 percent against the German mark from October to the end of December.

⁶ *International Monetary Statistics*, October 1978, p. 167.

⁷ Bundesbank, *Monthly Report*, August 1978, p. 74.

⁸ *Ibid.*, p. 74.

⁹ President Carter's statement of Dec. 21, 1977, *IMF Survey*, Jan. 9, 1978, p. 8.

On December 27, 1977, President Carter announced the intention of the U.S. Government "to intervene to the extent necessary to counter disorderly conditions in the exchange market." On January 4, 1978, the U.S. Treasury and the Federal Reserve Board issued a joint statement outlining steps in implementing the new policy. The Exchange Stabilization Fund of the U.S. Treasury of \$4.7 billion would be utilized actively together with the \$20 billion swap network operated by the Federal Reserve System. (According to agreements among the Group of Ten countries, central banks are to intervene in foreign exchange markets to smooth out erratic fluctuations.) A new swap arrangement between the Treasury and the Deutsche Bundesbank would provide the Exchange Stabilization Fund with an additional \$2 billion line of credit which could be drawn on for intervention in the dollar market.¹⁰

On March 13, 1978, the U.S. Treasury and the West German Finance Ministry reached a further agreement to work together to defend the dollar. As a result the Federal Reserve "increased its swap arrangements with the Bundesbank from \$2 billion to \$4 billion, thereby enlarging the Fed's total swap network with 14 central banks and the Bank for International Settlements to \$22.16 billion." In addition, the Treasury stated that it was prepared to sell \$740 million special drawing rights to the Bundesbank to buy marks. And the United States said that it would be willing to draw on its reserves of about \$5 billion at the IMF, if and as necessary, to acquire additional foreign exchange to support the dollar.¹¹

Foreign exchange traders questioned whether enough had been done to restore confidence, and the dollar continued to decline. After a short time it began to consolidate its position a little above the 2-mark level. But in the latter part of July a new run on the dollar developed. By October 30 it had dropped to 1.7151 marks to the dollar.¹²

Thus, throughout the past year, the depreciation of the dollar has been a key factor in United States-West German relations. The two Governments have been in close touch, and the German Government has been consistently helpful. Not only through providing new lines of credit but also by direct purchases of dollars, it has contributed to preventing a runaway plunge of the dollar. At the same time German officials have urged the United States to adopt stringent measures to reduce its dependence on imported oil.

F. THE ADVISABILITY OF GERMAN REFLATION

In early January 1977 pressure began to be applied by the United States, other OECD members, and the organization's Secretariat upon the Federal Republic to induce it to increase its economic growth rate. They wished to assign to the strong German economy the role of "locomotive" to pull the weaker European countries out of their doldrums.

¹⁰ Ibid., p. 1.

¹¹ IMF Survey, Mar. 20, 1978, p. 8.

¹² Wall Street Journal, Oct. 31, 1978, p. 2.

During the preparatory period before an economic summit meeting held in London in May 1977, U.S. officials at various levels made vigorous efforts to persuade the German Chancellor to modify what some U.S. economists viewed as his overcautious policy and his unreasonable fears of inflation. Chancellor Schmidt took occasion to make clear the fixity of his views. In late January, the New York Times quoted him as saying that he would resist "any pressure from President Carter's advisers to pump in more money to stimulate the economy—at least until the planned economic meeting * * *" ¹³

In fact the Germans passed a medium-term infrastructure investment program in the spring providing for some \$13 billion in additional Government investment during 1977–81. Presumably partly because of this German initiative, the tone of United States-German exchanges improved. Shortly before the conference opened there were statements from both West German and American sources that the two Governments were working closely together.

At the London Economic Summit the West German Government predicted that its economy would grow by about 5 percent in 1977 after allowing for inflation. However, in succeeding months the German economy slackened. In the second quarter of 1977 it grew only 0.5 percent at annual rates. In October 1977 the Germans passed a major tax cut program. But the average growth rate for the year was only 2.75 percent. Because of this disappointing record the United States-West German argument recommenced.

On their side American experts maintained that the German economy could expand considerably without danger of inflation. Pointing to the findings of highly respected German economic research institutes that the German industrial plant was utilizing only 81 percent of its capacity, and to an unemployment figure of 1 million workers, they came to the conclusion that production could be expanded without a serious increase in labor costs or inflation.

The Germans on their side argued that in their planning for the 1978 budget they had reached the limit for expansion. They pointed out that their deficit for 1978 would amount to about DM60 to DM65 billion or about 4.5 percent of GNP as compared to a deficit of 2.75 percent of GNP in 1977. German analysts figured that the budget deficit for the United States would amount to only 1 percent of GNP. For France and the United Kingdom the figures given were 3.5 percent and 1 percent of GNP, respectively.

In addition, German economists pointed out that the German characteristic of saving incremental income rather than spending it in uncertain times tended to dissipate the effectiveness of some reflationary programs. Thus they doubted the efficacy of additional fiscal and monetary stimuli in producing additional demand. They believed that structural changes were necessary which could not be achieved overnight. German planners were thinking in terms of developing new growth industries through research and development projects in such fields as alternate sources of energy.

The United States-West German arguments went on through early 1978 at different levels. In February, German Economics Minister Lambsdorff reportedly failed to convince the Carter administration

¹³ Ibid., Jan. 24, 1977, A6.

that U.S. demands for reflation were more than the West German economy could carry out. He was reported as saying that the American position was unacceptable.¹⁴

At this stage Secretary of the Treasury Blumenthal took a prominent part in the discussions. He continued to press for a stronger program of economic expansion than the German Government would accept. Chancellor Schmidt refused to consider such a program until he could see the results of incentives which the German Government has already applied. Subsequently the tone of the exchanges of view appears to have become more temperate. Thus, on February 23, 1978, the New York Times reported that "the United States and West Germany have agreed privately to end their lingering public arguments about economic policy."¹⁵ In June the New York Times quoted authoritative German sources as saying that West Germany was prepared to promote faster economic growth at home if other countries renounced protectionism and the United States promised to curb oil imports.¹⁶

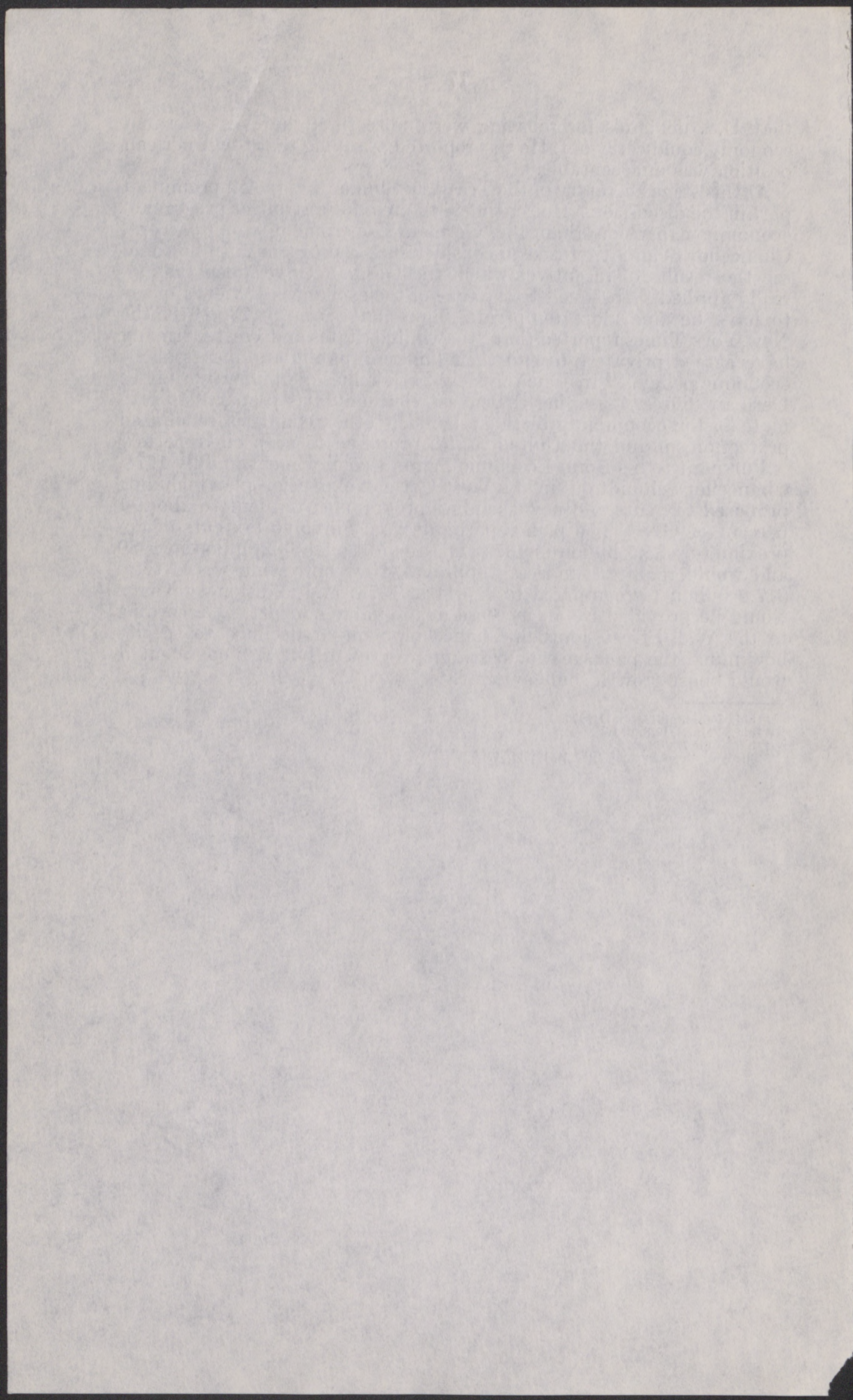
Pursuant to his Bonn Economic Summit commitment in July 1978, Chancellor Schmidt outlined a West German expansion plan including proposed tax cuts and new spending programs equivalent to about 1 percent of GNP. The plan reportedly would involve tax cuts of approximately \$5.5 billion in 1979 and an additional \$3.2 billion in 1980 and would require Bundestag approval. New borrowing would total \$17.9 billion (as compared to \$15.41 in 1978) and additional revenue would be provided by an increase in the value added tax. According to the Wall Street Journal, Chancellor Schmidt declined to specify how much the package would stimulate growth but was confident it would boost growth some amount.¹⁷

¹⁴ Ibid., Feb. 13, 1978, pp. D1, D6.

¹⁵ Ibid., Feb. 23, 1978, p. 1.

¹⁶ Ibid., June 7, 1978, p. 5.

¹⁷ The Wall Street Journal, July 31, 1978, p. 9.



III. BACKGROUND STATISTICAL DATA WITH COMMENTARY, 1955-75

A. GROSS NATIONAL PRODUCT

In an earlier report on the economic conditions in Italy, France, and the United Kingdom¹ the limits and peculiarities of statistics used in the earlier study are discussed briefly at pages 28-29. The cautionary comments given there are equally applicable to the statistical material contained in this report. The following tables are prepared so as to be comparable to the statistical data on Italy, France, and the United Kingdom in the committee print cited above. This material covers the period 1955-75.

TABLE III-1.—WEST GERMAN GROSS NATIONAL PRODUCT¹

Year:	Billion deutsche marks	Change year to year
1955	180.4	14.3
1956	198.8	10.2
1957	216.3	8.8
1958	231.5	7.0
1959	250.6	8.3
1960	302.3	20.6
1961	332.6	10.0
1962	360.1	8.3
1963	384.0	6.6
1964	420.9	9.6
1965	460.4	9.4
1966	490.7	6.6
1967	495.5	0.9
1968	540.0	9.0
1969	605.2	12.0
1970	685.6	13.3
1971	761.9	11.1
1972	833.9	9.5
1973	927.5	11.2
1974	997.0	7.5
1975	1,043.6	4.7

¹ For statistical data on the post-1975 period see pt. II.

Table III-1 above illustrates the steady growth of the West German economy. Throughout the 21-year period 1955-75 this GNP growth averaged out to 5.12 percent per annum, the highest rate in Western Europe, surpassing the French economic performance by 0.12 percent. Between 1955 and 1970 the rate averaged 6 percent per annum and varied from 11.6 to -0.2 percent. Like other European countries, German growth was set back by the impact of world conditions in the 1970's.

¹ See reference, p. VII.

TABLE III-2.—GROSS NATIONAL PRODUCT IN CONSTANT 1955 PRICES

	Billion deutsche marks	Change year to year
Year:		
1955.....	180.4	11.6
1956.....	191.2	10.6
1957.....	202.8	6.1
1958.....	209.7	3.4
1959.....	224.5	7.1
1960.....	243.7	8.6
1961.....	258.2	5.9
1962.....	268.4	4.0
1963.....	277.8	3.5
1964.....	296.2	6.6
1965.....	312.8	5.6
1966.....	322.0	2.9
1967.....	321.2	-0.25
1968.....	344.7	7.3
1969.....	373.07	8.2
1970.....	394.7	5.8
1971.....	406.6	3.0
1972.....	420.15	3.3
1973.....	441.8	5.2
1974.....	444.1	0.5
1975.....	429.9	-2.0

Note.—21-year average, 5.12.

Source: International Financial Statistics, vol. XXX, No. 5, May 1977, pp. 175-176.

From 1971 to 1977, despite West Germany's sound balance of payments position, economic growth was slow. Its annual growth rate for the 7 years averaged 2.7 percent. Thus the relatively modest German performance in 1977 has been consistent with its economic record throughout the decade.

TABLE III-3.—INFLATION

	Consumer Price Index (1955=100)	Percent changes in consumer prices (January to January)
Year:		
1955.....	100.0	1.5
1956.....	102.5	2.5
1957.....	104.7	2.1
1958.....	106.9	2.1
1959.....	108.1	1.1
1960.....	109.5	1.3
1961.....	112.0	2.3
1962.....	115.4	3.0
1963.....	118.8	2.9
1964.....	121.5	2.3
1965.....	125.5	3.3
1966.....	130.0	3.6
1967.....	132.2	1.6
1968.....	134.2	1.6
1969.....	136.8	1.9
1970.....	141.4	3.4
1971.....	148.9	5.3
1972.....	156.7	5.5
1973.....	167.5	6.9
1974.....	179.2	7.0
1975.....	190.0	6.0

Source: International Financial Statistics, vol. XXX, No. 5, May 1977, pp. 176-177.

B. INFLATION

The German Federal Republic maintained the lowest inflation rate in Western Europe during the period under review. From 1955 to 1970 its rate varied from 3.6 to 1.1 percent, while the average increase was 3.3 percent. The Germans were able to keep the rate under 7 percent throughout the 1970's with the single exception of 1974 when the impact of the quadrupling of oil prices drove the rate up to 7 percent. By comparison the average rate of inflation for the 1970-75 period was 7.3 percent for France, 10.4 percent for Italy, and 12 percent for the United Kingdom. The strong fear of runaway inflation instilled by German experiences directly after World War I and the experience with worthless money after World War II helps explain the strict Government policy of keeping a firm grip on inflationary pressures, even at the cost of slowing down the recovery of the economy after the recession of 1974-75.

C. POPULATION AND EMPLOYMENT

In 1939 the population living in what became the three western zones of occupation after the war numbered 39.3 million.² Between 1939 and 1975 the population of West Germany increased by more than half and totaled 61.8 million in 1975. The population figure dropped to 61.4 million in 1976.³ The greatest growth occurred between 1945 and 1961 when the largest migration in German history since the entrance of the Germanic tribes into Western Europe in the fourth century A.D. took place. Over 10 million East German refugees entered the Federal Republic before their escape routes were cut off by a closer surveillance of the intra-German border and the building of the Berlin Wall in 1961. West Germany benefited greatly from this steady influx of native Germans who were in general well equipped and highly motivated to rebuild the economy. After this source of supply was cut off German employers were forced to rely on workers from Southern Europe, especially Italy and Spain, and from Eastern Mediterranean and Middle Eastern countries, particularly Yugoslavia and Turkey. These sources supplied workers who were willing to take work which Germans refused to do and could be trained for industrial jobs as required. By 1973 the number of foreign workers peaked at approximately 2.5 million. As German unemployment rose during the 1974-75 recession many returned home. By 1978 it was estimated that about 700,000 had left.

² Wallich, Henry C., *Mainsprings of the German Revival*, New Haven, Yale University Press, 1955, p. 263.

³ *International Financial Statistics*, October 1978, p. 155.

TABLE III-3.—POPULATION AND EMPLOYMENT

[In millions]

Year:	Total population ¹ (midyear estimate)	Civilian labor force ²	Civilian employment ²	Number unemployed ²
1955	52.4			
1956	53.0			
1957	53.7			
1958	54.3			
1959	54.9	25.8	25.4	0.440
1960	55.4	26.0	25.8	.200
1961	56.2	26.2	26.0	.120
1962	56.8	26.3	26.1	.100
1963	57.4	26.4	26.2	.120
1964	58.0	26.3	26.2	.90
1965	58.6	26.4	26.3	.80
1966	59.2	26.4	26.3	.70
1967	59.3	25.8	25.6	.260
1968	59.5	25.7	25.4	.300
1969	60.0	26.0	25.8	.220
1970	60.7	26.2	26.1	.140
1971	61.3	26.3	26.2	.180
1972	61.7	26.1	26.1	.240
1973	62.0	26.4	26.2	.260
1974	62.0	26.3	25.7	.550
1975	61.8	26.0	24.9	1.020

¹ Source: International Financial Statistics, op. cit., pp. 176-177.

² These figures have been adjusted to U.S. concepts. They are based on tables prepared by the Bureau of Labor Statistics and printed in hearings before the Committee on Finance, U.S. Senate, 94th Cong., 2d sess., Jan. 29, 30, and Feb. 4, 5, 1976, entitled "Oversight Hearings on U.S. Foreign Trade Policy," U.S. Government Printing Office, 1976, pp. 33-36.

Since 1965 there has been a fall in the German birth rate. OECD analysts estimate that unless the rate is reversed "the German population of the Federal Republic will decline continuously between 1976 and 1980 by an estimated annual average of 209,000 or 0.4 percent."⁴

Between 1959 and 1974 the West German civilian employment remained quite stable in size, varying between 25.4 and 26.3 million. The recession of 1975 brought the figure to its lowest point of 24.9 million. Thus the German civilian employment situation resembled the situations in Italy, France, and the United Kingdom by showing relatively little change, unlike the situation in the United States where civilian employment increased 38 percent during this period. The percentage of women in the German labor force was relatively constant, representing between 37.4 and 36.4 percent of the total labor force⁵ during the 1959-75 period.

The German Federal Labor Office's Research Institute estimates that the German labor force will grow continuously between 1976 and 1989 despite the anticipated declining birth rate. The postwar baby boom should provide for an average annual rate of increase of 6.3 percent during the period. The Institute analysts anticipate a slow increase in female participation. They also foresee a decrease of male participation in both the lower and upper age groups because of additional schooling and the introduction of a flexible retirement age.⁶

⁴ OECD Economic Surveys, Germany, 1976, p. 22.

⁵ OECD Labor Force Statistics, 1959-1975.

⁶ Economic Surveys, Germany, op. cit., p. 22.

TABLE III-4.—*West German labor force distribution by sector*

[In percent]

1955:		
Agriculture	-----	3. 6
Industry	-----	64. 2
Other	-----	32. 2
1965:		
Agriculture	-----	10. 7
Industry	-----	49. 3
Other	-----	39. 8
1975:		
Agriculture	-----	7. 3
Industry	-----	46. 0
Other	-----	46. 7

The post-World War II division of Germany altered the ratio of agricultural to industrial and other labor because Eastern Germany was the center of prewar German agricultural production, whereas prewar German heavy industry and mineral extraction were located predominantly in what is now West Germany. In 1955, only 3.6 percent of the labor force worked in agriculture. By 1965, this figure rose to 10.7 percent. However, agricultural development in West Germany has only limited possibilities. Good arable land is in short supply, large areas being too sandy or covered by forest. Many farms are too small for economic cultivation. By 1975, the proportion of farmers to the total work force had dropped back to 7.3 percent. Thus, the Federal Republic resembles the United Kingdom rather than Italy or France in that no great internal migration occurred from farm to city to swell the industrial worker population. Between 1950 and 1961, East German refugees provided the major source for the expansion of the worker population. As noted above, this source was unusually well qualified in terms of skills and motivation.

D. INDUSTRIAL ACTIVITY

The data on employment in manufacturing compiled by the OECD should be considered only a general indicator of the manpower devoted to industrial production, since the OECD's definition of firms engaged in manufacturing as tabulated in the OECD Main Economic Indicators statistics had been changed over time. The index is constructed primarily on the basis of data on physical output in mining, manufacturing, electricity, and gas. Each country supplying material may then exclude or include other categories, thus making direct comparisons, with other OECD countries invalid.

Figures in table III-5 show that employment in manufacturing in West Germany grew by almost 1.2 million between 1955 and 1975. Declines occurred in recession years 1963, 1966-67, and 1974-75. The last recession reduced the number of persons employed in manufacturing by about 94,000 from the high point of 8.293 million, registered in 1970. While employment in manufacturing grew by 19 percent in the 20-year period, industrial production increased by 175 percent, indicating greatly increased productivity. Employment in manufacturing fell to 7.004 million in 1976.

The figures on days lost through labor disputes are taken from the West German Statistisches Jahrbuch. A comparison of the figures on West German labor disputes with comparable figures for Italy, France, and the United Kingdom illustrates the moderateness of German industrial relations compared with other European countries.

Between 1960 and 1975, West German industry lost 6,841,000 days because of strikes as compared to 249,568,000 for Italy, 63,062,000 for France, and 155,147,000 for the United Kingdom.⁷

TABLE III-5.—INDUSTRIAL ACTIVITY

Year:	Employed in manufacturing (thousands)	Industrial production index (1955=100)	Labor disputes time lost (thousand man-days)
1955	6,171	10	846
1956	6,599	110	263
1957	6,826	114	2,320
1958	7,013	120	779
1959	7,09	129	37
1960	7,46	149	61
1961	7,730	161	65
1962	7,790	166	450
1963	7,747	169	878
1964	7,805	18	16
1965	7,986	195	48
1966	7,949	193	27
1967	7,465	180	389
1968	7,562	203	225
1969	7,991	242	249
1970	8,293	264	92
1971	8,232	262	2,599
1972	8,058	277	60
1973	8,107	296	563
1974	7,891	293	1,051
1975	7,362	275	68

Source: OECD main economic indicators and Statistisches Jahrbuch fuer die Bundesrepublik Deutschland, 1955-76.

E. BALANCE OF PAYMENTS

As a guide to the use of the balance-of-payments table on the following page, the reader is referred to a list of definitions of the terms used in the first column of the table. These definitions are to be found on page 43 of the previously mentioned report on economic conditions in Italy, France, and the United Kingdom. (For a full citation, see p. vii above.)

West Germany's rate of growth in dollar terms of exports was exceeded among the industrial nations only by Japan and Italy. Between 1955 and 1972, the dollar value of West German exports increased more than seven times, and between 1972 and 1975 almost doubled again. The depreciation of the dollar and the inflationary pressures of the 1970's contributed greatly to this rapid increase in value expressed in dollar terms.

Since 1955, West Germany has never run an annual trade deficit—a record unmatched in Europe. In most years, however, the German invisible account has been in deficit. West Germany normally receives substantial amounts from transportation, investment income, and receipts from foreign troops stationed in Germany, but these were more than counterbalanced by travel of Germans abroad and other service expenditures. (In 1977, Germans spent roughly \$8 billion on travel.) Since 1961, remittances of foreign workers have been the largest item of private transfer payments. In the early 1970's, they amounted to between \$3 billion and \$4 billion a year.

⁷ Ibid.

TABLE III-6.—WEST GERMANY—SELECTED BALANCE OF PAYMENTS STATISTICS

[In millions of U.S. dollars]

	1955	1956	1957	1958	1959	1960	1961	1962	1963	1964	1965	1966	1967	1968	1969	1970	1971	1972	1973	1974	1975
Merchandise:																					
Trade (f.o.b.): ¹																					
Exports---	6,279	7,751	8,945	9,122	10,286	11,462	12,747	13,223	14,565	16,216	17,893	20,135	21,828	24,878	29,063	34,300	39,332	47,143	67,194	90,898	88,609
Imports---	5,486	6,166	7,138	7,277	8,380	9,382	10,250	11,562	12,394	13,940	16,728	17,326	16,786	19,417	24,057	28,130	32,951	39,222	52,593	69,194	70,959
Trade balance--	793	1,405	1,807	1,845	1,906	2,080	2,497	1,661	2,171	2,276	1,165	2,809	5,042	5,461	5,006	6,170	6,382	7,921	14,601	21,704	17,650
Invisibles-----	50	50	34	49	-125	-165	-650	-831	-732	-952	-1,251	-1,216	-935	-669	-882	-2,634	-2,204	-2,753	-4,372	-5,666	-6,692
Unrequited transfers-----	-287	-441	-450	-450	-773	-808	-1,112	-1,299	-1,273	-1,328	-1,605	-1,576	-1,606	-1,828	-2,253	-2,666	-3,292	-4,393	-5,929	-6,448	-7,100
Current account balance-----	1,068	1,400	1,444	1,444	1,008	1,107	-735	-423	566	-4	-1,691	17	2,501	2,964	1,931	870	886	775	4,300	9,590	3,858
Capital account balance-----	31	-586	-508	-508	-1,328	486	-777	-74	150	-444	586	209	-2,969	-1,581	-4,986	4,311	3,121	3,896	4,759	-9,770	-4,997
Official reserves transactions-----	-1,211	-1,220	-824	-824	371	-1,966	-60	226	-686	-107	325	-476	42	-1,702	3,034	-6,168	-4,576	-5,006	-9,156	694	854
Errors and omissions-----	114	406	-112	-112	-50	373	102	282	-46	555	780	255	426	319	21	987	571	335	97	-514	285
Total reserves--	3,017	4,202	5,197	5,879	4,791	7,033	7,165	6,957	7,882	7,430	8,029	8,029	8,153	9,948	7,129	13,610	18,657	23,785	33,171	32,398	31,034

¹ International Financial Statistics, May 1977, pp. 174-77.

During the 1955-75 period, there were only 4 years, 1961-62 and 1964-65, when the West German current account was in deficit. The first period coincided with an upward revaluation of the German mark and the second with the slump of German exports which led to the recession of 1966-67.

The West German annual capital account has ranged from a peak surplus of \$4,973 million in 1973 to a record deficit of \$9,590 million in 1974. The outflow of long-term German private capital did not begin to play a significant part in the West German capital account picture until 1968 when about \$2.5 billion of private capital was invested abroad. The average outflow of private capital has recently been around \$2 billion annually. (The total amount of German capital invested abroad is estimated at DM52.1 billion as compared to DM49.3 billion of foreign investment in West Germany.)

Perhaps the most impressive feature in the balance-of-payments table is the steady growth of West German international reserves.

Since 1955, these reserves have increased in value over 10 times.

F. EXCHANGE RATES

During the 1955-71 period the mark was consistently undervalued. On several occasions the German Government revalued the mark to bring it more in line with its real value. It was revalued in 1961 by 4.3 percent and again in 1969 by 9.3 percent.⁸ It continued to fluctuate slightly until 1971 when the United States ended the Bretton Woods system of keeping currency changes within strict limits by allowing the dollar to float. The German Government then allowed the mark to float. Since then there has been a steady appreciation of the mark.

A comparison of the dollar column on the table with the SDR column illustrates the dollar's present weakness. Particularly since 1975, the West German Government has been disturbed by the constant appreciation of the mark and is discussing methods for the stabilization of the dollar with the United States and other OECD countries (see above, pp. 14-15).

TABLE III-7.—DOLLAR AND SDR EXCHANGE RATES FOR THE DEUTSCHEMARK

Deutsche mark per SDR		Deutsche mark per dollar		Deutsche mark per SDR		Deutsche mark per dollar	
1955		4.215	1966			3.997	
1956		4.199	1967			3.999	
1957		4.202	1968			4.000	
1958		4.178	1969			3.690	
1959		4.170	1970		3.648	3.648	
1960		4.171	1971		3.548	3.268	
1961		3.996	1972		3.476	3.202	
1962		3.998	1973		3.260	2.703	
1963		3.975	1974		2.950	2.409	
1964		3.977	1975		3.069	2.622	
1965		4.006					

Source: International Financial Statistics, May 1977, pp. 174-175.

⁸ Ibid., p. 175.

G. IMPORT DEPENDENCE

The four standard trade categories on the following table were chosen because they provide a fair presentation of those areas of import dependence which would most seriously constrain the activities of the importing country if they were interrupted. The figures reflect the great inflation of international commodity prices which occurred during the period. For this reason the ratios between various categories are more important than the raw figures themselves.

During the period 1955-75, total West German imports increased from \$5,793 million to \$74,208 million. This represents an increase in value of over 15 times. In 1955, the four selected groups of imports represented 85.7 percent of total imports. At the end of the period this percentage decreased to 59 percent, reflecting the development of an increasingly affluent society importing larger amounts of consumer goods.

The reduction in the percentage of total imports devoted to food and live animal imports is of interest. In 1955, this category accounted for 24 percent of total imports. By 1975, this figure was reduced to 12 percent of the total, only slightly higher than the 10-percent figure for France in the same year.

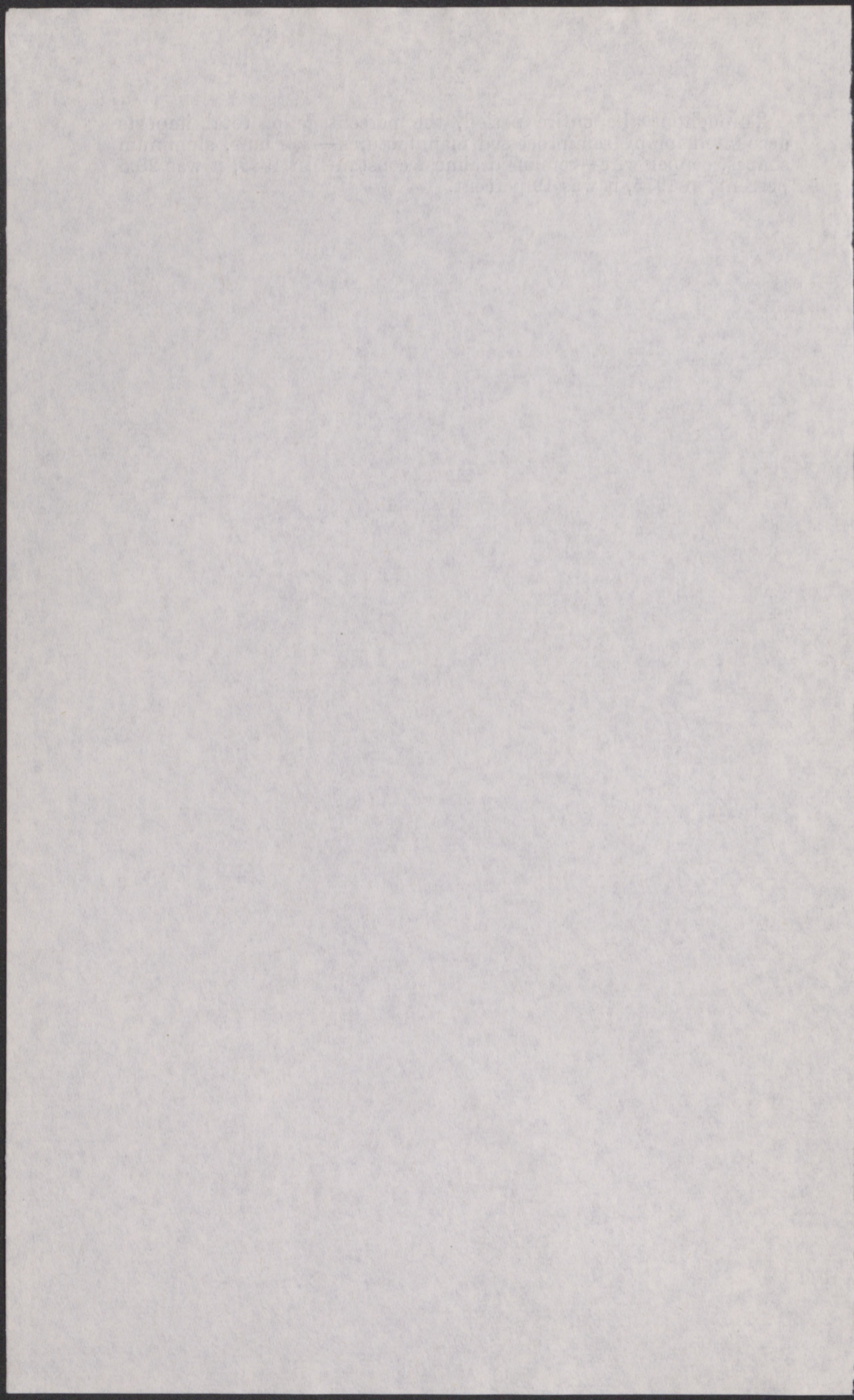
Mineral fuels accounted for 9 percent of total imports in 1955. The increase of the mineral fuels percentage from 11.4 percent in 1973 to 19 percent in 1974 and 1975 reflects the impact of the fourfold rise in the price of OPEC petroleum.

TABLE III-8.—IMPORT DEPENDENCES; SELECTED COMMODITY IMPORTS INTO WEST GERMANY
[In millions of dollars]

	1955	1956	1957	1958	1959	1960	1961	1962	1963	1964	1965	1966	1967	1968	1969	1970	1971	1972	1973	1974	1975
Total imports (c.i.f.)-	5,793	6,616	7,499	7,361	8,477	10,104	10,941	12,279	13,019	4,613	17,472	18,022	17,351	20,150	24,926	29,814	34,311	39,763	54,496	68,975	74,208
Food and live animals-----	1,423	1,745	1,909	1,786	2,683	2,123	2,335	2,744	2,508	2,723	3,343	3,393	3,245	3,376	3,927	4,549	5,080	6,101	8,345	8,502	9,550
Raw materials (excluding fuels)-----	1,845	1,912	2,149	1,764	1,861	2,309	2,276	2,183	2,233	2,688	2,823	2,833	2,588	2,968	3,437	3,755	3,131	4,198	4,198	6,116	7,332
Mineral fuels-----	507	714	867	750	681	783	870	1,061	1,225	1,342	3,164	1,494	1,735	2,057	2,208	2,626	3,502	3,672	6,210	13,308	13,099
Semiprocessed manufactures-----	1,191	1,257	1,369	1,476	1,826	2,363	2,508	2,685	2,809	3,414	4,984	4,221	3,796	4,950	6,315	7,243	7,653	9,093	12,262	13,862	14,129

Source: U.S. Year Books of International Trade Statistics, 1955-75.

Throughout the entire period, the percentage of total imports accounted for by semiprocessed manufactures—iron bars, aluminum shapes, copper wire—remained almost constant. In 1955, it was 20.5 percent; in 1975, it was 19 percent.



IV. INSTITUTIONAL FACTORS

A. THE MANAGERIAL CLASS

The defeat in World War II profoundly changed the social structure of West Germany. Some of the aristocrats, soldiers, public officials, and civil servants, who were at the top of the hierarchy, lost their standing. Crushing defeat stripped the military of its luster; the aristocrats were divided and often impoverished (those in East Germany were expropriated); in the mood of postwar cynicism politics had little appeal. In short, the industrialists, the bankers, and the merchants had become the most prestigious persons in the country, giving German management a hitherto unknown sense of assurance and power. This new self-confidence is reflected by the way businessmen think of themselves. One student of German management¹ has noted that they speak of their work as a "calling" and themselves as members of a special elite.

German top executives shared the German characteristics of energy, dedication to their jobs, and hard work. The engineering talent at their disposal was of high quality. The training German engineers receive from the German Technische Hochschulen (technical universities) is among the best available in Europe.

The style German managers set was an autocratic one, particularly in family businesses. A firm's top executive was likely to keep the decisionmaking power firmly in his own hands. The administrative structure was highly centralized. The function of initiating changes, in particular, was closely guarded. The German traditions of discipline, paternalism, and obedience which characterize other aspects of German life, such as family relations, also operated strongly in industrial relations. One American observed in the late 1950's that he found the German top executive "dominates with the omnipresence of an 18th century Hohenzollern."²

As German firms became bigger and older there was a tendency for them to become set in their ways. A failure to delegate prevented the adoption of modern methods of business management. In recent years Frank Vogl has reported there have been changes taking place in German companies. The recessions of 1967 and of the early 1970's have shaken many companies severely and forced them to modernize their business methods.³

The usual organizational structure of a corporate German firm provides for two directing bodies: The executive committee (Vorstand), and the supervisory board (Aufsichtsrat). The Vorstand runs the company and takes all the business decisions. Its chairman is the top executive officer. The other members are heads of the key departments

¹ Hartmann, Heinz. *Authority and Organization in German Management*. Westport, Conn., Greenwood Press, 1970, pp. 25-32 (first ed. 1959).

² *Ibid.*, 60.

³ Vogl, Frank. *German Business After the Economic Miracle*. New York, John Wiley & Sons, 1973, pp. 96-97.

of the firm. In many cases the chairman is the effective head of the company although in some companies the Vorstand acts in a collegial fashion and reaches decisions jointly. A Vorstand is small, generally numbering five or six.

The Aufsichtsrat represents the stockholders. It has no executive power and meets only two or three times a year. But its powers are significant because it can dismiss the chairman of the Vorstand, or the entire Vorstand, if it objects to the way the affairs of the company have been handled. In the case of the Krupp firm two Vorstand chairmen were forced to resign in a year.⁴

The unique feature of the German Aufsichtsrat is the participation of labor representatives on the board. Under the terms of the co-determination legislation of 1976 all firms employing more than 2,000 workers must provide for the election of labor representatives to one-half of the places on their Aufsichtsrat. Smaller firms must reserve one-third of the places for labor representatives.

A principal feature of the West German managerial system is the role played by banks. The three largest banks, the Deutsche Bank, the Dresdner Bank and the Commerzbank own more than 25 percent of a wide range of large German companies. For example, the Deutsche Bank has more than a 25-percent holding in Daimler-Benz, four machinery manufacturers, four textile companies, and diverse other industries. The other two banks operate on the same scale, as do smaller banks on a smaller scale. These holdings enable the banks to name directors on the supervisory boards of the companies concerned. With holdings of more than 25 percent a bank's representative is in a position to block any company decisions of which the bank disapproves. In some cases the banks are able to vote the stock of their customers by proxy. Thus through a series of interlocking relationships the banks can exercise a strong influence upon the German economy. In general they have encouraged mergers. Moreover, although the German economy has no planning machinery similar to the French national planning office, the close connections between top bankers and the Ministries of Finance and Economics tend to develop a coordinated view of how German economic policy should develop.⁵

The establishment of holding companies and mergers, in which German banks have been important participants, illustrates another characteristic of German businessmen—a preference for a managed home market rather than for aggressive competition. Writing in 1955, Henry Wallich commented on this trait as follows:

The disinclination of German businessmen to compete aggressively in the home market is interesting in several respects. It is of course perfectly natural for businessmen to combine in restraint of trade where the law does not interfere, since it means higher profits. The German penchant for order and organization also works in favor of cartelized markets. But the tendency toward cartels and similar protective arrangements may have deeper roots. In general these devices imply a surrender of opportunity in return for security. The possibility of conquering a bigger market is given up, or at least reduced.⁶

In conclusion, the effective way in which German managers operate in export markets deserves a special note. Firms like Volkswagen have won such a large part of many foreign markets by the most careful

⁴ Ibid., p. 37.

⁵ Schnitzler, Martin. *East and West Germany: A Comparative Economic Analysis*. New York, Praeger, 1972. pp. 156-157.

⁶ Wallich, op. cit., p. 336.

advance planning. They study every conceivable angle of the market and tailor their products and their sales pitches to the particular characteristics of each market. When their trade falls off they have been willing to absorb losses rather than risk losing connections which they have so laboriously developed.⁷

B. THE TRADE UNIONS

The Allied Occupation Authorities in West Germany early gave their approval to the rebuilding of the German trade union movement which had been suppressed by Hitler. By 1949, a single central organization for all German labor, comprising 16 nationwide industrial unions, came into being.⁸ This clearcut and orderly organization had great advantages. It avoided the confusion created by competing unions divided along religious or ideological lines, as was the case in France and Italy, or the innumerable disputes likely to occur among unions with overlapping jurisdictions, as was the case in the United Kingdom.

The major responsibility of the union is the negotiation of wage contracts since many other matters affecting labor are regulated by legislation—such as job security, vacations, and maternity benefits. Wages are generally negotiated between the organization on the state level of a union and an employer association. Prosperous firms, however, often pay wages far above the union scale.

Particularly in the 1950's, unions were moderate in their wage demands. The first generation of postwar labor leaders took account of the broad national interest in their dealings with management. Professor Wallich wrote in 1955 as follows:

The labor leadership, it is fair to say, has demonstrated remarkable statesmanship and breadth of vision. It has never lost sight of the interests of the economy as a whole, with its need for large-scale investment and financial stability, and has been mindful also of the repercussions of labor successes upon the weaker groups—pensioners and refugees.⁹

Some reasons for the moderate increases in German pay until the end of the 1960's have been suggested. In the 1950's and early 1960's German trade unions were relatively weak. Only about one-third of German workers joined a union. Older workers' memories of the failure of prewar union leaders to protect their interests dampened their enthusiasm for the labor movement. This lack of interest was strengthened by the long period of continuing economic expansion.

Furthermore, the German workman—particularly after the experiences of the early postwar period—put as high a value on job security as on wages. German workers were unlikely to go on strike unless they got generous strike pay and unions disliked using up their strike funds. The relations resulting from codetermination between top union officials and top management may have made it easier to make union leaders understand the problems of business management. Last the highly professional training which German union leaders receive facilitated the negotiating process.

⁷ Vogl, *op. cit.*, pp. 116-132.

⁸ Wallich, *op. cit.*, p. 305.

⁹ *Ibid.*, p. 310.

Aggressive action for higher wages was unusual until the latter part of the 1960's.¹⁰ One British observer, however, believes that an aggressive approach to labor relations on the part of West German unions is likely to continue because of the characteristics of the new generation of union leaders, whom he describes in the following terms:

The unions are being led in large measure now by a younger generation of well-educated men, who have travelled widely and learned a great deal about industrial relations, negotiating tactics and strikes from the militant union leaders in other countries. The men who rebuilt the unions after the war and who saw their jobs in close relation to the national interests of rebuilding a powerful industrial country, have been largely replaced by men who pay scant regard to the national interest, but whose sole interests concern increasing the power, influence and well-being of German workers.¹¹

An important feature of German labor organization is the works council. These councils are generally credited with having made an important contribution to the good labor-management relations that prevail in Germany.¹² The works council is altogether divorced from the union. Its members are chosen by the employees in a firm to represent them before management. The council handles grievances and deals with the improvement of unsatisfactory working conditions. But it weakens the unions because it prevents them from developing the close ties which exist between union officials and workers in the United States.

C. CODETERMINATION

The German codetermination law (*Mitbestimmungsrecht*) of 1951 and workshop constitution law of 1952 provide the basis for the representation of employees in the management of the firm in which they work. The notion of workmen's participation in management had been developed by leftwing thinkers in the 19th century. The concept was revived after the war and was incorporated into the social program of the Christian Democratic Party. It was strongly supported by the British occupation authorities. The Adenauer government introduced legislation establishing codetermination which was approved by the tripartite occupation authorities in 1951 and 1952.

In the case of coal and steel firms the codetermination law of 1951 provided that the employees of a firm should elect one-fourth of the members of the firm's supervisory board (*Aufsichtsrat*). One-fourth of the members were to be selected by the appropriate union and the remaining half by the stockholders and the management of the firm. A tiebreaking additional member was to be chosen by the labor and management-stockholder members. The law also provides that labor shall have a member on the executive committee (*Vorstand*) which is the center of executive control over the firm and takes all the business decisions (subject to review by the supervisory board). The labor member of the *Vorstand* is in charge of personnel matters and is considered a full equal of the other members.

Under the terms of the 1952 workshop constitution law, which applied to companies other than coal and steel companies, the labor role was considerably reduced. The labor representation was set at one-third of the supervisory board and no labor representative sat on the executive committee.

¹⁰ Some strikes did occur during the 1950's and early 1960's. For example, there were sizable strikes in 1951, 1953, 1954, 1957, and 1964. Schnitzler, *op. cit.*, p. 182.

¹¹ Vogl, *op. cit.*, p. 75.

¹² Wallich, *op. cit.*, p. 307.

The codetermination law of 1976 applies to all firms employing more than 2,000. It covers about 600 companies, including approximately 50 subsidiaries of U.S. firms. Under the new law one-half of the members of the supervisory board must be labor representatives who are elected under complicated provisions. A director of labor is to be included in the executive committee but the law does not give the employees a veto over his appointment.¹³

Companies had until June 30, 1978, to comply with its provisions. Corporations employing between 500 and 2,000 workers will continue to be governed by the workshop constitution law of 1952.

D. THE WEST GERMAN CIVIL SERVICE¹⁴

Following World War II and the complete dismantling of the German Government under Allied occupation, a new administrative system had to be established. After considerable debate over alternative systems, the civil service was restored basically in its prewar form.

The new service retained much of the power and job benefits of its predecessor but the social standing of the civil servant declined significantly. This loss of prestige has been traced to the collapse of the Third Reich, which left the civil service demoralized and discredited. Another factor affecting the image and position of the civil service has been the change of its class composition. The bureaucracy has become increasingly middle class under German democracy. Furthermore, recruits no longer necessarily represent the brightest among university graduates, as they once did. Private industry, with its higher salaries, is attracting more top graduates.

The Federal Republic employed as of 1970 over 2.1 million people in the civil service. Under the Federal system, the administration of the Government is carried out at the Federal, State, and local levels. Officials at all three levels have civil service status.

Administration at the Federal level is carried out by the ministries. Each ministry is divided into sections headed by a ministerial director, who is the immediate subordinate of the minister and serves at the minister's pleasure. Technically, the position of ministerial director is the only political appointment below the minister. The next rank of ministerial manager (Ministerialdirigent) is a civil service appointment with security and protection, although the position is not immune to political influence. Owing to the small number of non-civil-service positions within the ministries, the bureaucracy has a greater role in top-level decisionmaking than civil servants in most countries. Since much of the minister's time is occupied by party duties, civil servants are left in charge of a large share of the administrative functions.

German Government personnel are divided into three categories: Officials (Beamte), employees (Angestellte), and workers (Arbeiter).

¹³ The constitutionality of a section of the 1976 law has been challenged by the German Federation of Industry and is now under review by the Federal Constitutional Court.

¹⁴ This section is based on a report on the West German civil service contained in "History of Civil Service Merit Systems of the United States and Selected Foreign Countries together with Executive Reorganization Studies and Personnel Studies" compiled by the Library of Congress, Congressional Research Service for the Subcommittee on Manpower and Civil Service of the Committee on Post Office and Civil Service, House of Representatives, 95th Cong., 2d sess., Dec. 31, 1976, p. 391-410.

All three categories are to be found at the Federal, State, and local government levels. The Beamte category is subdivided into basic service, middle service, executive service, and higher service.

The German civil service elite is the higher service of the Beamte. A university degree not in a specific field and an extended probationary period are required for admission. Acceptance in the higher service opens the door to the highest echelons of government. The higher service includes approximately 10 percent of officials.

In practice entrants into the higher service have law degrees, with specialization in administrative law. Indeed the German law faculties are said to perform the role of the British public schools and the French Grandes Ecoles in preparing students for public service. (Public administration was introduced only recently as a field of study in German universities.) The heavy representation of lawyers in the civil service may account for the German tradition of legal consciousness and legalism among bureaucrats.

Since university enrollment continues to consist largely of students from upper- and middle-class families, the charge is frequently made that the Government is not doing enough to open up the civil service recruitment process.

Today, as before, mobility between the different categories of the civil service is virtually nonexistent. There are some opportunities to advance from the basic to the middle service, as a result of similar educational requirements. However, promotion from the middle to the executive service or from the executive to the higher service occurs only in the most exceptional cases. The opportunity for advancement is greatest within the higher service. The German civil service has traditionally been depicted as one in which length of tenure is the sole determinant of rank.

In practice, the German civil service has become highly politicized. The loose relationship between ministers and parliament is credited with having brought about a tight bond between the political executive and the civil service, resulting in what critics have called a politicized bureaucracy and a bureaucratized policy. There is considerable movement between the career civil service and elective office. Many leading postwar politicians have civil service backgrounds at the local, State, and Federal level.

During a span of two decades the degree of politicization in the bureaucracy was not apparent because one party, the Christian Democrats, governed continuously. However, with the transfer of government to the SPD in 1969, there was a change of approximately 20 percent of division head positions. Although the changes were not necessarily based on party affiliations, political motivations appeared to be a major factor.

In conclusion, the German civil service has undergone considerable expansion and adaptation in the postwar period, without formal change in the structure of the service or the laws governing it. In general, the service is viewed as responding adequately to the changing needs of modern West Germany and performing efficiently. At the same time, there is a growing body of opinion that changes are needed in the organization, training, career development, and standardization of job benefits.

E. GOVERNMENTAL STABILITY

The drafters of the German basic law took particular pains to guard the new republic from the destabilizing effects of frequent changes in government. They hoped to avoid a repetition of the series of weak and shifting governments of the Weimar Republic and the French Third Republic by making it more difficult to bring down a government by a vote of no confidence.

The method by which they proposed to do so was introduced by article 67 of the basic law, which reads as follows:

The Bundestag can express its lack of confidence in the Federal Chancellor only by electing a successor with a majority of its members and requesting the Federal President to dismiss the Federal Chancellor. The Federal President must comply with the request and appoint the person elected.¹⁵

This provision ruled out the long interregnums which occurred in both Italy and France. It also made it possible for Chancellor Adenauer to govern the Federal Republic with an iron hand for his first term in office (1949–53) by a majority of one because there was no other party leader who could command a majority.

Despite the ingenuity of the drafters of the basic law, the evolution of the German party system has made it easier to change governments than in the early days. The tendency of the smaller parties in West Germany to dwindle has left only three parties qualified to sit in the Bundestag by obtaining the obligatory 5 percent of the total vote. Since the two major parties—the CDU/CSU and the SPD—are very close to one another in size, the third party, the Free Democratic Party (FDP), is in a position to decide who shall be Chancellor. (Only on one occasion did a German party have a majority. In 1957 the CDU won 50.2 percent of the vote or 277 seats out of a total of 519¹⁶ of which 12 were nonvoting Berlin seats.)

It was the FDP which forced Chancellor Erhard to step down in 1966 by withdrawing from the FDP-CDU coalition. This prepared the way for the CDU-SPD coalition of 1966–69 in which Willy Brandt served as Foreign Minister. In the election of 1969 the FDP agreed to join the SPD, thus making Willy Brandt the first postwar SPD Chancellor and placing the CDU Party in the opposition for the first time. The key importance of the FDP has been shown by the fact that the Ministry of Foreign Affairs has been given to an FDP member regularly since 1969, despite the small size of the parliamentary party (40 seats).

The FDP-SPD coalition has continued from 1969 up to the present although since 1976 it rests on a majority of only 10 seats. It should be able to continue up to the next Federal election, scheduled for 1980, provided the SPD takes account of the limits of FDP support of the alliance. If that point is passed, the FDP might decide to switch again and support the CDU. Under present circumstances, however, it would be difficult for the FDP to change sides before the 1980 election without weakening its own electoral chances by antagonizing members of the party who favor a SPD-FDP coalition.

¹⁵ Peaslee, Amos J., *Constitutions of Nations*, Second edition, La Hague, Netherlands, Martinus Nijhoff, 1956, p. 41.

¹⁶ In 1969 the SPD came within 3 percent of the CDU/CSU. Sontheimer, Kurt, *The Government and Politics of West Germany*, New York, Praeger Publishers, 1973, p. 87.

In local elections on June 6, 1978, the FDP received less than 5 percent in Hamburg and Lower Saxony.¹⁷ After the 1980 election, the FDP party leaders, if they surmount the 5-percent barrier, should be in a stronger position to change the party's alignment. A postelection FDP-CDU coalition should not be ruled out.

There are changes occurring in the SPD, which, if they come to dominate party policy, might lead to the breakdown of the present coalition. It seems unlikely, however, that such changes would take place before 1980. Among younger SPD members there is a growing movement in the direction of the traditional Socialist policies which were abandoned in 1959. The party leadership has long had difficulty in keeping the young Socialists and the left wing of the party in line. If the economic situation in the Federal Republic worsens and orthodox remedies fail to reduce unemployment, radical socialists are likely to call for increased public spending, the application of controls suitable for a siege economy, and the large-scale nationalization of industry. Up to the present the SPD left has had little influence on party policy.

Under the pressure of the recession of 1974-75 and its aftermath—particularly the high level of unemployment—the SPD has lost in popular support. SPD seats in the Bundestag dropped from 230 in 1972 to 214 in 1976. (The earlier figures reflect Brandt's popularity.) The pressure of the upcoming 1980 Federal parliamentary election will also come to bear on the FDP, which faces the possibility of falling below the 5-percent limit. These pressures may work against the introduction of new programs, particularly in view of the smallness of the Government's majority.

If the CDU/CSU returns to power, no profound changes in economic policy are likely to occur because the differences between the present Chancellor and the CDU/CSU are not great. The most likely changes would be a curtailment of the growth of social benefits and further reductions in personal and corporate taxes to stimulate business.

The Federal Republic has experienced none of the large-scale demonstrations that have shaken France, and no radical political developments have occurred like the near victory of the French left in March 1978 or the increasing political power of the Communists in Italy.

But the existence of the Red Army faction in the Federal Republic, supported by a small number of students and young intellectuals and admired by a larger number of young people who are not active participants, raises questions both within West Germany and without. As in the case of other countries where powerful terrorist organizations are in operation, the chilling efficiency of the terrorists cannot fail to make people wonder to what extent the terrorists may be able to disrupt civilian life and destabilize the government.

The German phenomenon is disturbing because it is hard to tell how far and how deep it extends. The influence of Marxist, Maoist, and nihilist professors in German universities is strong. To some, the vision of destroying society so that utopia can rise from the ashes is compelling. In seeking to explain these attitudes, German writers have pointed to the rejection of the values of the older generation in Germany by their children. It has been suggested that the immediate postwar generation's obsession with money and material things may have repelled children who had never known the deprivations of the

¹⁷ New York Times, June 6, 1978, p. 4.

1940's. Some have asked whether the present generation has not been the victim of German history because a late unification, two defeats, and Nazism have left a disturbed and confusing legacy devoid of the stabilizing influences of deeply rooted traditions.

Such ruminations cannot fail to arouse questions about the stability of the German political system. But it must also be borne in mind that the German postwar performance has been remarkable in many ways. Germans have been exemplary in carrying out their responsibilities. The quality of their top officials has been generally high. Popular support for democratic institutions has been consistently strong.

F. THE ECONOMIC PHILOSOPHIES OF WEST GERMAN POLITICAL PARTIES

(1) THE CHRISTIAN DEMOCRATIC UNION/CHRISTIAN SOCIALIST UNION

As the largest closely linked political party grouping in the Federal Republic, the Christian Democratic Union/Christian Socialist Union (CDU/CSU) represents a wide range of interests.¹⁸ Founded directly after the war as a union of Catholics and Protestants without precedent in German history, its philosophy contains views from Christian leaders espousing social justice, the improvement of living and working conditions for workers, and the strengthening of Christian education. Through their influence, plans were developed for codetermination in industry which gave the German labor movement the greatest voice in the management of industry in the European Community.

The party also reflected the views of industrialists, bankers, lawyers, and other members of the managerial and professional classes. In accordance with these members' interests, the party has advocated the policies of free enterprise and free trade developed by Ludwig Erhard as Economics Minister. In general terms, the party stands for a minimum of Government interference in the operation of the economic system, though CDU governments have not made major attempts to return to private hands those parts of the German industrial structure which have been under Government control. An exception is the case of the Volkswagen firm, which had been established as a state-owned company by Hitler. Its stock was sold in small denominations to private investors. The party accepts the need for Government operation in some sectors of the economy, such as the railroads, and for state ownership of large blocks of stock in other cases, such as the big hydroelectric complex VEBA.

In the 1960's, CDU economic policy changed significantly. The continuous boom of the Adenauer period called for little Government direction. But in the post-Adenauer period a series of business cycles with troughs in 1963, 1966-67, 1971, and 1974-75 required more governmental action to keep market forces in balance. The CDU, in coalition with the SPD, agreed on the necessity of economic management along Keynesian lines and sponsored new legislation in 1965-67 to enlarge the Government's power to deal with economic crisis.

Since the retirement of Adenauer, the CDU Party has lost much of its creative force. Kurt Sontheimer has described this situation in the following terms:

¹⁸ The Christian Democratic Union and the Christian Socialist Union, which is the religiously oriented party in Bavaria, are organized as separate parties along geographic lines, but they function as a single entity on the national level.

The vigor of the beginning period, which with all its economic growth had encouraged many to vote for the CDU, began to slacken off. The CDU which had started off as an at least partly progressive force in German politics became more and more a defender of what had been without developing any new ideas for the future of Germany. This explains why from 1966 onward under Kiesinger's government the CDU's image was that of a weak party governed by too many divergent interests, a party which had drawn to it too many opportunists and which had become prey to an immobility which it tried pathetically to cover up with rhetoric, not always without nationalist undertones.¹⁹

(2) THE SOCIAL DEMOCRATIC PARTY

As noted above, the Social Democratic Party changed its orientation in the late 1950's under the direction of Herbert Wehner. The party leadership dropped the traditional prewar platform of a Socialist party with its emphasis in the transformation of the economic system through large-scale nationalization. In its place in 1959 it adopted the Godesberg program which accepted the general outlines of a free enterprise system but called for constant improvements in social programs and the status of the working class within the framework of a market economy.

When the party entered the Government as a partner with the CDU in 1966, it gave support to a program calling for stronger Government direction of economic affairs than had been the case in the Adenauer period. SPD economist Prof. Karl Schiller became the Minister of Economics in 1966 and continued in this position in the coalition formed between the SPD and FDP in 1969. During the 6 years when he was in charge of economic policy, Schiller conducted it along Keynesian lines. He used the Government's ability to regulate such key economic factors as the money supply, the discount rate, the level of taxation, and the size of governmental expenditures to dampen down inflation and protect the soundness of the German mark.

Schiller resigned in 1972 over policy differences within the party. His decision to limit Government expenditures and constrict the economy to avoid inflation was overruled in the Cabinet in favor of a more expansionist policy to combat unemployment.

The leading figure in the determination of economic policy after Schiller's resignation has been Helmut Schmidt, first as Economics Minister and since 1974 as Chancellor. Schmidt has not been as dedicated to the prevention of inflation at all costs as his predecessor and has permitted some reflation of the economy. But he continues to place great importance on antiinflationary measures. He has kept inflation in the last 2 years at rate of 4.5 percent or less, at the cost of high unemployment and an economy which grew in 1977 at a rate of only 2.75 percent.

Willy Brandt, who resigned as Chancellor in 1974 as the result of a spy scandal in his private office in which he was in no way implicated, is now secretary general of the party. Although sometimes critical of foreign policy actions of FDP Foreign Secretary Genscher, there are no signs that Brandt has ambitions to regain the chancellorship. Nor is it likely that Brandt, who comes from the right wing of the party, would become a leader of the party's left wing. He has supported Schmidt's policies throughout and, although temperamentally different from him, apparently has great respect for his abilities.

¹⁹ Sontheimer, *op. cit.*, p. 88.

There are indications that younger Social Democrats are becoming increasingly dissatisfied with the present leadership. Professor Hallett has described the change which is taking place as follows:

During the period of the SPD-FDP coalition, the SPD moved markedly to the left. The Young Socialists, in effect, rejected the Godesberg program and returned to the policy of complete state ownership of the means of production, distribution and exchange which had been the party's policy in the immediate postwar years. Without going so far, many leading members of the party became skeptical of "social market economy" and "global guidance"; they began to favor a more dirigiste economic policy. The view gained wide acceptance that, so long as its victims were compensated (for example through "dynamic pensions") an annual inflation of 4, 5, 6 percent was nothing to worry about, and certainly unimportant compared with other objectives, such as the fullest possible level of employment.²⁰

(3) THE FREE DEMOCRATIC PARTY

The members of the Free Democratic Party who backed the SPD coalition in 1969 are economic liberals. They believe in free trade and private enterprise. But they are ready to support Keynesian measures in times of economic recession and are generally pragmatic in their approach to economic problems. They have little difficulty in supporting the programs of Chancellor Schmidt. However, if the left wing of the SPD were able to move into a position in which they could determine party policy along protectionist and nationalization lines, it seems likely the FDP members would be forced to leave the coalition because of their own economic philosophy and the attitudes of their electorate.

²⁰ Hallett, *op. cit.*, pp. 80-81.

V. CONCLUDING COMMENT

The previous paper on Italy, France, and the United Kingdom ended with a set of hypothetical scenarios outlining various possible future developments in each of the three countries. That this does not seem to be a useful approach in the case of West Germany indicates the degree of stability and continuity of policy which that country has achieved.

Of course the Federal Republic is subject to numerous stresses and strains. The interrelationship of East and West Germany and the unsolved problem of German reunification remain as sources of insecurity. But the decision initiated by the Brandt Government to accept a long-term *modus vivendi* with East Germany suggests that East-West German relations can continue indefinitely as they are. As we have seen, the German economy faces structural problems. Continued unemployment, if linked with inflation and the radicalism of the extreme left, might bring about political difficulties. But the prospects of this happening in the near future appear small.

A. SHORT-TERM POLITICAL POSSIBILITIES

In the short run, however, there are various possible courses which West German developments might take. Given the narrowness of the SPD-FDP coalition majority of 10, elections held before the termination of the present Bundestag's term of office in 1980 cannot be ruled out. If the Government is unable to enact an important part of its legislative program because of defections among its supporters or deaths or the loss of a two-thirds majority in the Upper House of the German Parliament (as a result of a CDU victory in a state election) a new national election might take place before 1980.

In the case of a general election in 1980 or before, the FDP may fail to win the necessary 5 percent to enter the Bundestag, as the party did in recent state elections in Hamburg and Lower Saxony. If this should happen the membership of the Bundestag might be reduced to the two major parties. Up to the present the SPD has never succeeded in winning a larger percentage of the national vote than the CDU. If the FDP does enter the new parliament it is not certain that the party will choose to continue its coalition alliance with the SPD. In short, although Helmut Schmidt's chances of continuing as Chancellor now appear good, they cannot be taken for granted.

The names most frequently named as candidates for the chancellorship in the event the CDU can command a parliamentary majority are Helmut Kohl, longtime leader of the CDU Party, Ernst Albrecht, Premier of Lower Saxony, Alfred Dregger, leader of the CDU Party in the pivotal state of Hesse, and Franz Josef Strauss, leader of the Bavarian CDU. Strauss is an independent-minded maverick who

occasionally is at odds with CDU Party leaders. He is thought to be considering running a slate of candidates for a yet to be formed National Party in the upcoming election to the European Parliament as a trial balloon.

As noted above (see p. 38), under any CDU/CSU leader there would probably not be major changes in German economic policy. There is little likelihood that any moderate German Government would draw the country away from its close identification with basic U.S. military, political, and economic policies. The entry of a conservative government, however, might strengthen the left wing of the SPD Party, thus increasing leftwing influence in the trade unions, making industrial relations more contentious, and lessening the degree of popular consensus on policy which had been one of West Germany's major strengths.

B. U.S. POLICY OBJECTIVES AND THE FEDERAL REPUBLIC OF GERMANY

The State Department has summarized U.S. policy aims in respect to the Federal Republic of Germany (FRG) in the following terms:

- (1) To maintain confidence in the U.S. commitment to the security of Europe and the FRG;
- (2) To encourage a major FRG contribution to NATO;
- (3) To consult closely with the FRG on matters affecting its vital interest;
- (4) To cooperate closely with the FRG in efforts to minimize nuclear proliferation;
- (5) To coordinate U.S. and FRG economic policy both bilaterally and in international forums such as the OECD;
- (6) To maintain U.S. rights and responsibilities in Berlin and provide for the viability of the city.

The main lines of United States-West German cooperation seem well established. West Germany refused to weaken this association despite the efforts of President de Gaulle in the midsixties to create a strong Franco-German entente at the expense of the United States. This demonstrated how deep was the German conviction that the Federal Republic's exposed military position required a close partnership with the United States within the North Atlantic Alliance. An example is the enthusiastic German support for the continued strengthening of the Alliance under the 5-year program of increasing the NATO annual budget by 3 percent over and above inflation. Another example was the United States-German agreement to increase the standardization of NATO weapons by equipping the new U.S. XM-1 tank with a German gun. However, future competition for contract for standardized equipment will undoubtedly arise and may be more difficult to settle.

The sensitivity of West Germany to United States-Soviet bilateral negotiations will doubtless remain acute so that careful and thorough briefings during any such negotiations affecting German interests will continue to be in order. Multilateral negotiations with the Soviet Union in which the Federal Republic participates (such as the MBFR negotiations or the continuation of post-Helsinki discussions) should not be compromised by a change of Government in West Germany. On security and disarmament issues the CDU/CSU has consistently taken a harder line than the present Government. Thus no matter

which party is in power the Germans should continue to be firm in ruling out any proposals that they consider would weaken the German position in Central Europe.

The German urgent interest in developing advanced technologies which will enable them better to survive in future international competition and to meet their energy requirements may lead to future differences regarding the proper safeguards on the development and export of nuclear technologies. A portent of future controversies was given by the questions raised by the German contract to sell a nuclear reprocessing plant to Brazil.

As described above, German interests in the economic field generally reinforce those of the United States when major issues are involved. There will, of course, be clashes of interest involving special groups. German farmers support French and other EC farmers in insisting on the protective features of the common agricultural policy (CAP) to which U.S. agricultural exporters strongly object.

As members of the European Community, hard-pressed German industries, such as steel, may benefit from nontariff trade barriers erected by the European Community.

The West Germans are likely to resent too strong attempts to dictate German domestic economic policy as was the case in the U.S.-FRG argument about reflation versus inflation. The Germans will probably continue to criticize U.S. inability to control the size of its balance of payment deficits. But in the major issues of economic policy it seems likely that the United States and West German positions will tend to reinforce one another.

No matter what the coloration of any moderate government, there will be a common United States-West German interest in making the international economic system work. Thus it seems likely that this mutual interest will continue to produce in the end such agreements as the understandings between the U.S. Treasury and the German Ministry of Finance to work together to bolster the dollar. By the same token it is in the interest of any moderate German Government to work together with the United States in the OECD, the IMF, and other international organizations to improve relations with less developed countries which will become increasingly important in the future as sources of raw materials and markets for the advanced products of the older industrial countries.

C. A FINAL COMMENT

Finally, the elementary fact that politically and economically the Federal Republic is the strongest country in Europe should be re-emphasized. It is the only European country with liquid assets (in the form of over \$43 billion dollars in reserves) sufficiently large to be used constructively on a large scale for international purposes. Some Germans themselves have suggested using these reserves for a German version of the Marshall plan to strengthen the economies of candidates for membership in the European Community or for backing the development of a European currency. If the German Government decides to take concrete steps to carry out such plans, the European Community would receive a new impetus and West Germany would assume a leadership role which up to the present it has been careful to avoid.

which party is to power, the Germans should continue to be firm in making every possible effort to strengthen the German position in Central Europe.

The German interest in the development of advanced technology which will enable them better to survive in future international competition and to meet their energy requirements may lead to further differences over the proper allocation of the development and export of nuclear technology. A portion of these negotiations was covered by the position raised by the German committee to the nuclear negotiating panel in Berlin.

As indicated above, German interests in the non-nuclear energy field are those of the United States which regard energy as a vital element of national security. The German position is based on the fact that the United States has a monopoly in the field of atomic energy and that the United States has a strong interest in the development of nuclear energy.

As a result of the German position, Germany has been able to develop a strong interest in the development of nuclear energy. The German position is based on the fact that the United States has a monopoly in the field of atomic energy and that the United States has a strong interest in the development of nuclear energy. The German position is based on the fact that the United States has a monopoly in the field of atomic energy and that the United States has a strong interest in the development of nuclear energy.

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II. A Final Comment

Finally, it is necessary to state that Germany has a strong interest in the development of nuclear energy. The German position is based on the fact that the United States has a monopoly in the field of atomic energy and that the United States has a strong interest in the development of nuclear energy. The German position is based on the fact that the United States has a monopoly in the field of atomic energy and that the United States has a strong interest in the development of nuclear energy.