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Franz Peter Lang \*

## Can the German "Economic Miracle" be Repeated?

*Currently there is much discussion as to whether the chapter of West Germany's post-war history popularly known as the "Economic Miracle" can be repeated in the region of the former GDR. Professor Lang presents a series of factors which encouraged the West German economic miracle at that time, and examines whether corresponding conditions apply today in East Germany.*

Until now the concept of the "Economic Miracle" has hardly ever been more closely defined. We think of it essentially as the dynamism with which the economy of western Germany, badly destroyed by the war, caught up with the development of the world economy. The concept of the "Economic Miracle", however, has always been used as a propaganda slogan in the domestic political debate rather than as a synonym for any fully developed theoretical concept of macroeconomic rehabilitation.

In the past, endeavours to make good this deficit have principally been conducted by economic historians and economists concerned with questions of the economic order. Their studies essentially deal with the precise form and the chronological sequence of the measures taken.<sup>1</sup> In common, they all largely restrict themselves to examining how the institutional structure of the new economic order was established. This can easily lead to the misconception that organizing the institutional framework of economic activity was in itself the guarantee for success. These studies in fact only describe some of the preconditions for the historical occurrence of the "Economic Miracle". What were crucial to its success more than anything else, however, were the operating conditions presented by the real economy in West Germany and in the world economy at that time. If one ignores such factors, it is impossible to explain why economies such as those of France, Belgium and the Netherlands, which were certainly organized along similar market-economy lines, clearly enjoyed only much more modest success.

The Germans' state of consciousness immediately after the war was characterized by a combination of

sheer relief at having survived at all and extremely low expectations of the future. These low expectations were founded, on the one hand, on the perceptible material destruction and, on the other, on the atrocities of Nazi Germany which no one could any longer deny.

Yet the overall material situation was in fact better than it appeared when one looked at the considerable destruction of residential accommodation in the cities. Industry in the western part of Germany may have been severely hit, but its overall potential had actually only been partially destroyed. The loss of industrially usable buildings, for example, was limited to 20% of the available stock of 1939, hence four-fifths of industrial premises were still available for use.<sup>2</sup>

The production facilities which still remained, however, had largely been converted to the needs of autarchic wartime production<sup>3</sup> and had been brought to a standstill as a result of the more or less localized destruction of the infrastructure (roads, railways, waterways, utilities, etc.). This led the population to overestimate the extent of the material damage done to the economy's productive potential.

Despite the great number of war victims and prisoners of war, the stock of human capital was still substantially intact, even if it was at first completely disorganized<sup>4</sup> and

<sup>1</sup> Cf. H. Müller: Die westdeutsche Währungsreform von 1948, in: Deutsche Bundesbank: Währung und Wirtschaft in Deutschland 1876-1975, Frankfurt 1976, pp. 433 ff.

<sup>2</sup> Cf. W. Michalka: Zerstörung und bedingungslose Kapitulation: der Untergang des Deutschen Reiches, in: M. Vogt: Deutsche Geschichte, Stuttgart 1987, pp. 722 ff.

<sup>3</sup> Cf. *ibid.*, pp. 678 ff.

<sup>4</sup> On this, cf. e.g. the papers by Erker, Boyer, Fichtner and Hetzer in: M. Broszat et al. (eds.): Von Stalingrad zur Währungsreform, Munich 1988, pp. 365 ff.

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widely dispersed. People were essentially concerned with crisis management and coping with their own, individual problems of existence. Nevertheless their typical qualifications were still geared to industrial technology and, by international comparison, were of a high standard. Given the dire organizational condition the state and the economy were in, however, they could not be put to proper use and appeared superfluous.

To this extent, as far as Germany's endowment with real and human capital is concerned,<sup>5</sup> relatively favourable preconditions for a rapid upward development in the economy did exist in the wake of the defeat, contrary to the external appearances which shaped people's expectations. In addition, the stock of human capital was gradually increased by the continuous stream of returning prisoners of war and the influx of displaced persons, and the parliamentary and bureaucratic structures at local and *Land* levels were reconstructed relatively quickly.

## Changes in the Economic Order

It was against this background in the real economy that, beginning as early as 1947, the reformed economic order was put into place.<sup>6</sup> That reformed system, associated with the names of Erhard, Müller-Armack, Eucken and others, has been widely described and discussed as the concept of the social market economy.<sup>7</sup> There is thus no need to recapitulate all its constituent elements here;<sup>8</sup> instead, only its most important effects will be singled out for attention.

The currency reform created unified, controllable monetary conditions, which are essential to smooth economic development. What appears especially important here is the effect of the substantial elimination of financial burdens inherited from the war period, with a rigour which could probably only have been possible in the climate of expectations peculiar to those years.

The market economy provided a relatively large degree of economic liberality, whilst assuring a welfare safety net for individuals who were temporarily unable to participate in the markets. The range of benefits at that time was, however, considerably narrower than it is today, and the competitive system also initially left considerable scope for regulation.<sup>9</sup>

These reforms formed the central legal and organizational cornerstones for economic developments in the years following 1948. The upward trend in the economy, however, did not establish itself quickly, nor did it pass off without problems for the real economy.<sup>10</sup>

As well as these domestic measures, changes in the international economic order were also of great importance. One of these was the new international monetary system agreed at Bretton Woods in 1944, which established a completely new and relatively clear order for the monetary relations between nations on the basis of fixed exchange rates. The other significant innovation was the General Agreement on Tariffs and Trade (GATT) set up in 1948, which was intended to direct the system of the international exchange of goods on to a readily visible course in accordance with the principle of free trade. It contributed to a considerable expansion in world trade. The up-and-coming West German economy was gradually able to integrate itself into this newly constituted world trading order.<sup>11</sup>

In addition to these reforms which benefited the entire Western world, the Marshall Plan (European Recovery Program) with its investment aid to boost the reconstruction effort was also of special importance, though by no means crucial, to the West German economy.<sup>12</sup>

To sum up, changes took place at that time which created better domestic and international conditions for economic activity. These however also benefited other Western economies.

## The Reconstruction of the Infrastructure

The war had left Germany with many local pockets of destruction in its infrastructure. This was a fundamental cause of the almost total collapse of economic activity. However, emergency measures were already beginning to be taken in the years up to 1948 to provisionally plug the important gaps in the infrastructure. The administration of the *Länder* and the transport network, for example, were able to operate again as early as 1948, even if substantial bottlenecks did remain. At the

<sup>5</sup> The same, incidentally, can be said of the zone which subsequently became the GDR.

<sup>6</sup> For a comprehensive account of the interrelated events and conditions, cf. W. Abels hauser: *Wirtschaftsgeschichte der BRD 1945-1980*, Frankfurt 1983, pp. 151 ff.

<sup>7</sup> Cf. W. Stützel et al. (eds.): *Grundtexte zur Sozialen Marktwirtschaft*, Stuttgart 1981.

<sup>8</sup> Cf. D. Lös ch: *The Post-War Transformation of West Germany's Economy: A Model for the GDR?*, in: *INTERECONOMICS*, Vol. 25, No. 2, 1990, pp. 90 ff.

<sup>9</sup> Cf. *ibid.*

<sup>10</sup> Cf. W. Stützel: *Sicherung der Sozialen Marktwirtschaft durch konsequente Ordnungspolitik*, in: W. Stützel et al. (eds.), *op. cit.*, pp. 341 ff.

<sup>11</sup> Cf. P. Wulf: *Deutschland nach 1945*, in: M. Vogt, *op. cit.*, pp. 728 ff.

<sup>12</sup> Cf. *ibid.*, pp. 742 ff.

same time, it must be remembered that in West Germany, too, parts of the existing production facilities had been dismantled as reparations in kind.

It was now possible for the political and organizational new beginning to be accompanied by the systematic reorganization and reconstruction of the infrastructure. The main burden in the early stages was borne by branches of industry which had suffered relatively less destruction such as coal-mining and certain areas of heavy industry. As more and more of the railway system was brought back into operation, their products could be more readily transported to many localities to play their part in the reconstruction or could even be exported. At the same time, the Marshall Plan funds enabled focal points in the infrastructure and in the key industries to be rapidly put back into operation.

A partially destroyed transport network and energy supply system is virtually unusable. However, if the destroyed parts are restored it can again be fully available for productive purposes within a very short time. The effect of these repairs to a partially destroyed system in creating an impetus to economic development in the early stages of reconstruction of the country must not be underestimated. There was also a similar effect, however, in the other countries which had suffered destruction during the war.

### **Mobilization of Real and Human Capital**

A similar situation existed when it came to restoring the industrial production plants to operation which had ceased to function either as a result of war damage, restructuring to supply the war economy, or being dismantled for reparation purposes. In view of the great crisis management skills which had developed during

the war, it was possible to rapidly reorganize the partially destroyed industrial potential even under unfavourable conditions. This was also true for the state regulatory authorities (administrative departments, parliaments, governments).

The replacement of the destroyed or dismantled production facilities which was gradually taking place also created growth impetus on the supply side. At the same time it should be noted that the higher technical standards of the new plants made possible far greater productivity from the existing labour force. The simultaneous influx of qualified workers, including increasing numbers from the Soviet Zone of Occupation, reinforced the improvement on the supply side of the economy.<sup>13</sup> This latter effect did not apply to the same extent in the other European countries hit by wartime destruction.

Reconstruction in the western part of Germany, then, was considerably enhanced by the effects flowing from the reorganization and restoration of the locally destroyed infrastructure, the production facilities and the stock of human capital.

### **Key Function of Capital Formation**

It was possible to conduct all these activities under exceptionally favourable cost conditions since the labour force, probably as a result of low expectations of the future, was very modest in its real wage demands, yet was willing to put in a great deal of productive effort. Conditions for reconstruction were further improved by low social security costs and the very elastic supply of labour due to the stream of returning prisoners of war.

<sup>13</sup> Cf. P. Erker: Revolution des Dorfes, in: M. Broszat et al. (eds.), op. cit., pp. 367 ff.

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The considerable productivity-enhancing effects were hence scarcely passed on in real wage increases to employees for consumptive purposes. As a consequence, private-sector investors from abroad were increasingly encouraged by the high yields available compared with other countries to risk investments in West Germany, and this additional investment allowed a further acceleration of the economic reconstruction process. As a result of these general conditions, price increases on the goods market were kept within bounds. The universal wage restraint also permitted the accumulation of equity on a broad basis which in turn meant that small and medium-sized business has developed to a very broad extent in West Germany when this is compared internationally, and such businesses increasingly became a vital factor in economic development.

On the one hand, the high accumulation of capital created the right conditions for a rapid growth of productive capacity whose increasing rate of utilization during the reconstruction period in return led to a distinct improvement in the availability of goods to the public, and set the scene for increased exports within the GATT framework. These impulses again created a fresh incentive to extend the industrial base and enabled a more rapid resurrection of the tertiary sector, housing construction, government social security provisions, etc.

### Protection via the Exchange Rate

The new international monetary system established in Bretton Woods had initially assigned the new Deutschmark a fixed parity of DM 4.50 to the dollar. For years this parity entailed a strong element of protection for the German export economy, whilst at the same time hindering foreign competition on domestic markets. The exchange rate and the relative stability of prices therefore contributed to the favourable development of the economy by improving the balance of trade.

Concurrent with this there were considerable restrictions of, for example, foreign tourism and international capital transactions until 1957/58.<sup>14</sup> In this way the net influx of foreign investment and the gradual elimination of the current account deficits which initially existed served to stabilize the development of the economy. The new institutional conditions provided by the free international trade and monetary systems were extraordinarily beneficial to these developments. In

addition, the Korean War allowed gaps in the international market to arise, in which the strengthening West German economy was able to establish itself.

### Accumulation of Disadvantages Abroad

The real competitive advantages in the West German economy stood in contrast to specific disadvantages in other countries organized along market economy lines. In Germany, for example, the currency reform had to a large extent removed the burdens inherited from the internal financing of the war.<sup>15</sup> The victorious powers, on the other hand, had to meet the costs of having financed the war via the existing market mechanisms, without any far-reaching currency reforms. Their economies hence began with a burden of considerable government debt, which scarcely left any leeway for reductions in interest rates or for tax cuts which would stimulate expansion. In addition, the victorious European powers ended the war with considerable foreign debt to the USA, which under the Bretton Woods system had to be settled at fixed exchange rates.

Their production structures had also largely been geared to the war economy and had to be reorganized. On top of this, the dismantling of out-of-date production plants in Germany and their reconstruction in the receiving countries – undertaken as reparations for the war – did not trigger off any innovation-induced productivity boost, and instead merely transferred obsolete technology. This also meant that a considerable amount of labour was tied up with work which did not allow innovative activity. It cannot be ruled out that this adversely affected the conditions of these countries at the outset of the dynamic post-war period of economic development.

On top of all this, the victory over Germany had led their people to have considerable expectations for the future which could only be disappointed by developments during the phase of reconstruction. This disappointment consequently led, amongst other things, to demands for compensation through real wage increases, which inhibited rather than promoted growth in these countries, notwithstanding the fact that they too had market economies. Trends in costs and demand brought about a situation in which even imports from Germany were needed for the reconstruction. The course of developments in the former enemy states hence directly enhanced reconstruction in West Germany.

As a result of these various stimuli, economic development took place in West Germany with a dynamism that the public had not expected. In view of the pessimistic outlook at the outset, most were

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<sup>14</sup> Cf. H. Müller, *op. cit.*, pp. 433 ff.

<sup>15</sup> Cf. D. Lösch, *op. cit.*, pp. 90 f.

therefore pleasantly surprised. That was reflected in a growing motivation of the people, in increasing political approval for the representatives of the market economy concept, and in a high degree of stability in industrial relations. These had feedback effects on the reviving economy and boosted the dynamism of the development process. It is precisely this self-reinforcing dynamism of real economic forces which goes to make up the essence of the economic miracle in the western part of Germany.

### **Repetition in East Germany?**

The preceding considerations have shown that it was not the economic order alone which brought about the West German economy's rapid revival. The surrounding international conditions (GATT, Bretton Woods, the European Recovery Program) were at least of equal importance.

However, a key role was played by the conditions presented by the real economy, as already outlined, which were based on the special situation of Germany as the loser of the Second World War. These characteristic, and presumably unique, historical conditions were not present in this form in the other market-oriented countries although they had comparable economic systems. This shows that the programme for currency reform and for the social market economy as an explanation for the rapid upturn in West German economic fortunes is only one condition, albeit a necessary one.<sup>16</sup>

It hence seems reasonable to suppose that the legal and organizational mechanisms of the social market economy may not suffice for economic successes comparable to those attained in West Germany after the war to be achieved within the territory of the former GDR without major assistance from the western part of the new Germany. The reason for this lies in the lack of essential real-economic preconditions. Hence it is not a matter of the former GDR being a region with an economy which is "only" partially destroyed and with "only" a demoralized working population with modest expectations of the future.

In East Germany, the economy is universally obsolete, both in technological and in organizational

terms, and the human resources are inappropriately qualified.<sup>17</sup> This applies to the scientific-technical field and even more to that of entrepreneurial know-how. The mobilization of the productive forces of the East German economy first of all presupposes considerable investment in both real and human capital (training and retraining). This necessary structural change will take several years. Since neither type of investment can be borne by endogenous earnings in the short term, considerable aid from West Germany will be necessary for at least the medium term.

There is, however, another important factor. The expectations of the people of the GDR are directed towards greater consumption rather than towards improved performance and wage restraint. Nor do the demonstration effects which emanate from prospering West Germany allow any realistic chance of the latter. The chances of any rapid accumulation of equity within the economic area of the former GDR are hence slight.

Likewise, the international situation is not comparable with that of the immediate post-war period. The East German economy must be fitted into a world of established, highly developed competitors. All around the world these efficient competitors, including those from West Germany, are ready and easily able to meet East Germany's demand out of their own idle capacities. The present productive capacity of East Germany is not needed either in the western markets or for its own restructuring.<sup>18</sup>

To solve the economic problems in the territory of the former GDR without considerable and long-sustained injections of outside funds will primarily require a take-off in endogenous growth forces. These include, above all else, a readiness to perform (high productivity), restraint in real wage demands and in consumption. All this, of course, cannot be brought about by force in a liberal, social market economy, but must be decided by the people of their own free will. However, as long as priority is given to catching up on the years of missed consumption and as long as the "welfare-state mentality" played upon by the politicians continues to prevail, it will not be possible to repeat an economic miracle in the territory of the former GDR.

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<sup>16</sup> Rather, the history of the early days of the Federal Republic shows that the concept of the social market economy only managed to survive politically because the conditions in the real economy were so very favourable. Had this not been the case, it would hardly have been possible in political terms to stick to the market-oriented course throughout the tedious, problematic early stages. As a case in point, Erhard was repeatedly forced to defend himself whenever crises arose against critics from within his own camp who wanted him to at least partially abandon the liberal economic concept. Cf. D. L ö s c h , op. cit., pp. 93f.

<sup>17</sup> This is a sober conclusion one is bound to reach following the initial experiences made by small and medium-sized companies cooperating or trading with enterprises from the GDR. The conclusion is also confirmed by an evaluation of training courses staged for GDR managers. Cf. the contributions by Schneider and Lang in: Ruoss und Partner (ed.): Dokumentation zum DDR-Informationseminar für die Nahrungs- und Genußmittelwirtschaft, Frankfurt 1990.

<sup>18</sup> Cf. F. P. Lang : Den COMECON-Handel forcieren, in: Deutsche Handelszeitung, 30th March 1990, pp. 100 ff.