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**POLICY COORDINATION IN FIGHTING INFLATION
IN WEST GERMANY, 1973–1975:
RECONSIDERATION OVER THE ROLE OF FISCAL POLICY**

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Abstract: This study aims to examine how the government, the Bundesbank and the wage bargainers reacted to the rapid increase in inflation, and how they interacted with each other to fight inflation between 1973 and 1975 mainly with primary sources collected in Germany. This examination leads to the conclusion that policy making by both the government and the Bundesbank was well-coordinated not only in a high inflationary period but also in recession. This is totally different from static models assumed by earlier literature in comparative political economy, such as studies regarding central bank independence and coordination of wage bargaining.

Key words: Policy Coordination, Inflation, West Germany, Fiscal Policy, Central Bank Independence.

JEL Classification Number: E31, E52, E58, E62, E63, E64, H53

1. INTRODUCTION

Wilhelm Vocke, the President of the Bank Deutscher Länder, stated that it was the government's abuse of its monopoly over currency issuance that brought about currency fluctuations in the world, and hence central bank independence is essential in order to prevent inflation¹. This is the typical support argument for the necessity of central bank independence. At least it seems that such an argument can be justified in West Germany (hereinafter referred to as Germany), due to the people who twice experienced hyperinflation fully supporting monetary reforms to raise central bank independence. This argument is also justified from a democracy perspective according to Howarth and Loedel (2003), who state "the Bundesbank had become the guarantor of German democracy by acting as a guide, protecting the German government from irresponsible policy that could destabilize the democratic order. Arguably, then, monetary stability and social stability are one and the same²".

In addition, there have been a number of academic studies proving that there is a clear correlation between central bank independence and economic performance, such

¹ Refer to Wilhelm Vocke (1956=1958:152).

² Refer to Howarth and Loedel (2003:54).

as inflation and unemployment rate³. In these studies, Germany has been regarded as one of the most famous cases to support arguments for such effects of central bank independence, since the Bundesbank is one of the most independent central banks in the world and Germany has been able to achieve low rates of inflation at the same time. Consequently, in recent years, such a “doctrine” has come to be more broadly accepted worldwide.

However, this is still a highly debatable topic in some respects. First, do “the Germans” still regard central bank independence an indispensable factor? A social research report “Fame and Reputation of the Bundesbank” gives us some clues to answer this question⁴. The public opinion poll with a random sample of 2,000 people was carried out by the Bundesbank in the 1980s. There are two main questions in the questionnaire, the first question is “who is responsible for the present price stability (or what is the main factor explaining it)”, and the second is “what are your political priorities”. As to the former, surprisingly, only 2% of all the people questioned answered “the Bundesbank” while 40% chose “the Federal Government, the Minister of Finance and the Minister of Economics”. As for the latter, interestingly 73% answered “reduction in the number of the unemployed is more important than price stability”⁵. As described above, most of “the Germans” did not have sufficient knowledge to answer general questions on the Bundesbank correctly and did not recognize price stability as their top political priority.

Secondly, with regards to the correlation between central bank independence and economic performance, if a country reformed Central Bank regulations to raise its independence, could it achieve better inflation records? Contrary to the prevailing studies revealing such a correlation, Oshima and Ide (2006), through a closer historical examination of Japan and German cases, argue that central bank independence and its related regulations do not necessarily guarantee that the central bank keep pursuing tight monetary policy to combat inflation⁶. In addition, some state that coordination of wage bargaining is a crucial factor explaining gaps in economic performance among countries⁷.

Given these facts, the meaning of central bank independence cannot solely be defined

³ As to central bank independence, refer to Webb and Neyapti (1992), Alesina and Summers (1993).

⁴ Infratest Sozialforschung „Bekanntheit und Ansehen der Deutschen Bundesbank“, München, April 1987, 865716. This social research report was furnished by the Bundesbank.

⁵ It is certain that about a half of the people questioned agreed with an opinion “unemployment problems can only be solved in the long run if inflation could be kept under control”. Nevertheless, it was the older generation and less-educated people that were strongly inclined to agree with such a view. It implies that the younger generation and well-educated people tended to have different insights into the argument. In other words, it can be considered that the German mindset towards inflation and the Bundesbank has gradually changed as time has passed.

⁶ Berger (1997) also seems to regard the central bank law as a misleading indicator for the political independence of the central bank. In other words, there might be a certain gap between its legal status and actual political standing.

⁷ As for the coordination of wage bargaining, refer to Bruno and Sachs (1985) and Tarantelli (1986). Moreover, Hall and Franzese (1998) regarded an interaction between these two institutions as a main factor determining the gaps.

in terms of its law but is rather diverse, and its impact on the economy can change according to the historical context. In that case, how has Germany managed to maintain price stability while the top political priority of “the Germans” has gradually shifted from price stability to improvement in employment? Could the Bundesbank always refuse demands of the government and the unions to attain its purpose? What role did the other participants, such as the government and wage bargainers, play in fighting inflation? In order to answer these puzzling questions, we will examine in this article how the participants, including not only the Bundesbank but also the government and wage bargainers, behaved to restrain inflation, based on primary sources collected in Germany⁸.

The period covered in this article is from 1973 to 1975. There are three reasons why it is set in such a way. The first reason is, as Figure 1 demonstrates, that the period when Germany began to attain relatively low rates of inflation in the four main European industrial countries was clearly from 1973 to 1975. The second reason is that, in the 1960s and the early 1970s, fiscal policy and income policy were considered indispensable measures to combat inflation, because the freedom of monetary policy action was tightly circumscribed by continual short-term speculations against the Deutschmark (DM) from foreign countries. The third reason is that some argue that the relationship between the government and the Bundesbank in the 1970s was much closer than that in the other periods⁹.

Hence, the main aim of this article is examining how the Bundesbank, the government and the wage bargainers reacted to the rapid increase in inflation and how they interacted with each other to fight inflation between 1973 and 1975. For instance, let us suppose that in order to moderate inflationary pressures, the government and the Bundesbank would naturally tighten the fiscal and monetary policy and the wage bargainers moderate wage increases. However in order for these to happen, there must be some factors motivating these participants to do so due to their totally different political interests, so this study is also an attempt to find such motives given by the other participants in their political exchanges. With the fact mainly based on primary sources, describing actual interactions among the main participants and their motives to combat inflation during the crucial period, which has not been strongly focused so far, can be the most significant contribution of this research to the studies of earlier literature¹⁰.

⁸ The primary sources used in this article were collected in Archiv der Sozialen Demokratie, Bonn (AdSD), the Historisches Archiv der Deutschen Bundesbank (HA Bbk) and the Bundesarchiv Koblenz (BArch).

⁹ Marsh (1992) mentioned that the relationship between the government and the Bundesbank was really close in the 1970s. For example, Dr. Karl Klasen was present at Cabinet meetings in Bonn on the average 7, 8 times in a year, and Karl Otto Pöhl, the State Secretary of the Ministry of Finance (1972–1977), was also present at the Central Bank Council 21 times between 1973 and 1976. Considering the fact that Hans Tietmeyer, the State Secretary of the Ministry of Finance in the 1980s, was present at the Central Bank Council only 11 times between 1983 and 1989, it is easy to understand how close the relationship in the 1970s was. Refer to Marsh (1992=1993: 207).

¹⁰ It should be mentioned in advance that this article will not answer a question, how much the behavior of each economic actor contributed to the economic outcomes in quantity.

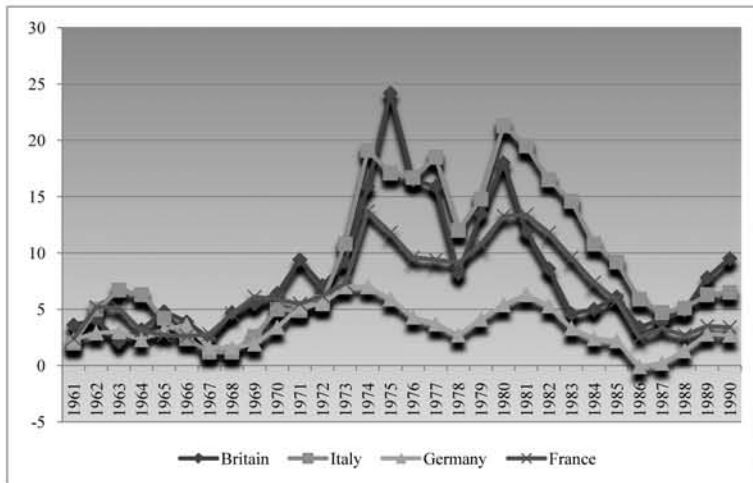


Figure 1. Inflation Rates

Source: International Financial Statistics Yearbook.

To achieve the aim of this study, the article is divided into four main parts. First, the outline of the Stability and Growth Act which legally enabled policy makers to pursue fiscal and income policy to maintain economic equilibrium, will be explained in the following chapter. In the same chapter, since the Act came into force in June 1967, we will also consider the question, what kind of policy the government and the Bundesbank have carried out to combat inflation. Secondly, it will be argued whether the aims of economic policies were in accord among such participants at the time. Furthermore, the question on how each participant has dealt with economic problems facing Germany to maintain price stability will also be examined. Thirdly, we will discuss what led to wage moderation. Finally, we will examine whether theoretical explanations in earlier literature can be reasonable enough to reveal how the participants actually interacted between 1973 and 1975.

2. THE STABILITY AND GROWTH ACT AND ECONOMIC POLICY

2.1. *The Stability and Growth Act*¹¹

In this chapter, let us clarify the analytical issue of this study quantitatively. Before doing so, some points of the Stability and Growth Act will be briefly explained in this section. After the DM became fully convertible in 1958, freedom of monetary policy action came to be limited by constant short-term speculations against the DM. To overcome this difficulty, the federal parliament passed the Act in 1967 that sought to formalize cooperation among the participants, and enabled the government to use fiscal policy in order to maintain economic equilibrium.

¹¹ Concerning the Stability and Growth Act, refer to Stern, Münch and Hansmeyer (1967) and Sagami (1966–1968).

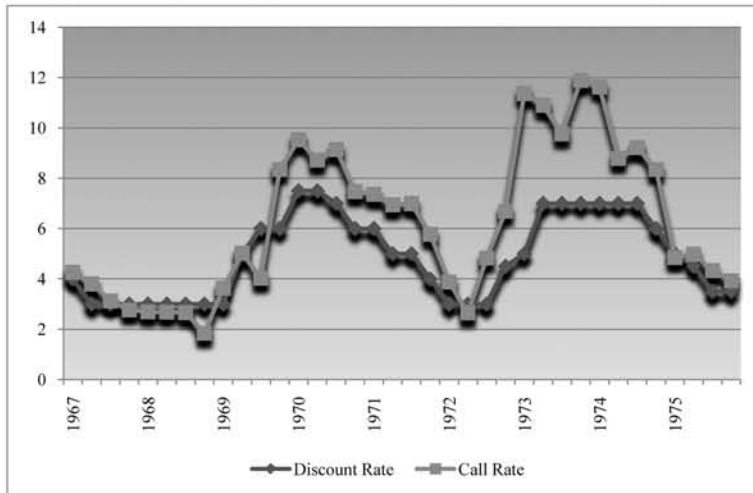


Figure 2. Discount Rate Trends
Source: OECD Main Economic Indicators.

The first article of this Act provides that in their economic and fiscal measures, the federal and Länder governments shall consider the requirements of general economic equilibrium and its measures shall be taken in a way that they will help to stabilize prices, maintain a high level of employment, and achieve external balance, accompanied by adequate economic growth. It also imposed a responsibility to pursue its aim on all the participants, including the Bundesbank. To be concrete, the law allowed the government to 1) change income and corporate tax rates within $\pm 10\%$ by a government ordinance, 2) place limitations on depreciation, 3) establish anti-cyclical reserves, 4) place limitations on borrowing, and 5) provide data as a guideline for wage bargaining. In this way, the law enabled fiscal policy and income policy to be used not only to stimulate economy but also to dampen inflation.

2.2. Economic Policy under the Stability and Growth Act¹²

Now, how have the main participants dealt with economic problems to stabilize the economy under the Stability and Growth Act? Figure 2 shows the official discount rate trends. It demonstrates that the Bundesbank raised the discount rate to 7.5% by March 1970, which is its peak in this period, and shortly afterwards lowered it to 3%, and started to raise it rapidly again in October 1972. The reason why the Bundesbank decreased its rate once in 1970 is that the high interest rate seemed to cause more massive short-term speculations. Finally, it reached 7% by the second quarter 1973 and began to fall sharply again in October 1974¹³.

¹² General arguments in this section are mainly based on Machida (1974).

¹³ As for the minimum reserve ratio, the Bundesbank lowered it by approximately 1% in January 1974. In this sense, it can be argued that the Bundesbank had already started to ease its policy stance before October 1974. Refer to Monatsberichte der Deutschen Bundesbank, Dezember 1976.

In March 1973, the German government decided to shift to the floating exchange rate system, and it is commonly said that its decision allowed the Bundesbank to be freed from external constraints to some extent because the obligation to intervene in support of the US dollar was over¹⁴. As a result, the Bundesbank succeeded in lowering free liquid reserves of the bank to practically zero, using all the monetary tightening measures, such as restriction and suspension of Lombard lending, together with the continuous increase in discount rate. Thus, the rise in inflation rate stopped and started to decline shortly afterwards. Soon after it had become obvious that inflation rate decreased, a new monetary measure, monetary targeting was adopted as a kind of “disguised incomes policy” in December 1974¹⁵. In other words, monetary targeting was introduced to influence inflationary expectations of the public, namely wage bargaining.

Although the Stability and Growth Act enabled the government to utilize fiscal policy as a weapon against inflation, the effectiveness of this measure tended to be restricted by political oppositions and the German decentralized financial system¹⁶. Especially, oppositions to tax increase as an anti-cyclical fiscal measure were extremely strong¹⁷. Such oppositions to anti-cyclical fiscal policy were moderated in 1973, as restraining inflation became the most urgent task for all of the political parties, including the opposition parties. Under such conditions, the Federal Government decided to bring its fiscal policy into alignment with the tight monetary policy of the Bundesbank, and finally adopted two economic stabilization programs, which were based on the Stability and Growth Act.

In February 1973, the first economic stabilization program was introduced. This program enabled the Federal Government to 1) impose a stability surtax on people in the upper income brackets, 2) use federal stability loans, 3) cut investment tax credit, 4) carry out temporal suspension of depreciation, and 5) deposit natural or automatic increase in revenue in the Bundesbank¹⁸. Further, in May 1973, the second economic stabilization program was introduced. It allowed the Federal Government to 1) impose a stability surtax on people in the upper and middle income brackets, 2) adopt a temporal investment tax, 3) carry out temporal suspension of depreciation, 4) restrict borrowing, 5) carry out temporal suspension of special depreciation on new houses, 6) decrease the Federal Government expenditure, excluding mandatory expenditure, by 5%, and 7) make use of federal stability loans.

Table 3 illustrates how the amount of special deposits of the federal and Länder governments at the Bundesbank has changed¹⁹. The notable point in Table 3 is that its amount in 1973 and 1974 became larger than in the other years because of the effect of

¹⁴ Refer to Hagen (1999: 403).

¹⁵ Refer to Johnson (1998: 94).

¹⁶ Refer to Machida (1979: 1).

¹⁷ According to Machida (1979), in most of the cases, tax increase has been opposed by SPD and FDP.

¹⁸ Investment tax is tax on self-consuming goods.

¹⁹ The special deposits were established to counter disturbance of general economic equilibrium. In accordance with the Stability and Growth Act, the increase in revenue owing to restrictive fiscal measures taken by the federal and Länder governments shall be deposited in the Bundesbank.

Table 1. Special Deposits of the Federal and Länder Governments at the Bundesbank

Mio DM	1969	1970	1971	1972	1973	1974	1975
Mandatory anticyclical reserves	436	2936	2936	2936	2936	1668	1668
Federal Government		1500	1500	1500	1500	1477	1477
Länder Government	436	1436	1436	1436	1436	191	191
Voluntary anticyclical reserves			1195	1000	1000	1000	1000
Federal Government			1000	1000	1000	1000	1000
Länder Government			195				
Stability Surcharge					934	3462	543
Federal Government					389	1545	543
Länder Government(1)					546	1917	
Investment Tax					235	868	244
Federal Government					147	632	244
Länder Government					88	237	
Immobilisation of tax receipts in 1973					690		
Federal Government					610		
Länder Government					80		
Federal stability loan		256(2)			2500	2500	
Anticyclical surcharge on income taxes		2189	5879	251	170		
Total	436	5381	10010	4188	8466	10753	3455
Federal Government	1756	2500	2500	6146	7177	3264	
Länder Government(1)	436	1436	1631	1436	2150	3576	191
Anticyclical surcharge on income taxes		2189	5879	251	170		

Source: Monthly report of the Deutsche Bundesbank, 1976 Dec.

(1) Including funds due to local authorities (14% of the receipts from the surcharge on assessed income tax and wage tax), which are held on the Länder governments' accounts (2) Federal Government education loans — Discrepancies in the totals are due to rounding.

these two economic stabilization programs²⁰.

In addition, these two programs tightened the scale of construction projects and the cost of approved building, especially that of residential buildings in 1973 and 1974. Table 4 demonstrates that the total cost of construction projects and the cost of residential buildings had increased sharply until they started to fall in 1973. In 1959, Heinrich Tröger, who was the Vice-President of the Bundesbank at the time, asked the government to reform the financial system to enable fiscal policy to be used as a weapon in combating inflation by a letter. In this letter, he stated that a large amount of investment in construction was regarded as the principal factor causing an economic boom²¹. Resultingly, the government carried out financial reform based on the Stability and Growth Act in the 1960s, which enabled the Federal Government to use fiscal policy to fight inflation, and succeeded in decreasing the cost of construction with the improved fiscal measures, such as temporal suspension of special depreciation on new houses, in the

²⁰ It is certain that its amount in 1971 was also large, but unlike the other special deposits, anti-cyclical surcharge on income taxes was a temporal measure and had to be returned to taxpayers in the end. Given the fact, it can be considered that the scale of special deposits in 1971 was practically small.

²¹ HA Bbk N-2/243.

Table 2. Construction Projects and Housing Finance

	Estimated cost of approved buildings			
	Total		Residential buildings	
	Mio DM	Change on year	Mio DM	Change on year
1967	41483	-7.2	26062	-8.7
1968	43187	4.1	27031	3.7
1969	49521	14.7	29541	9.3
1970	59058	19.3	35529	20.3
1971	73588	24.6	47011	32.3
1972	87228	18.5	57217	21.7
1973	85869	-1.6	55692	-2.7
1974	72151	-16.0	41941	-24.7
1975	73775	2.3	40475	-3.5

Source: Monthly report of the Deutsche Bundesbank, 1976 Dec.

early 1970s.

As to income policy, just after the Stability and Growth Act came into force, wage bargainers seemed to follow the guideline announced by the Federal Government²². Yet, once wildcat strike occurred in the fall of 1969, the rate of wage growth started to rise sharply. Table 5 illustrates that the growth rate in metal and steel industries have been about 9% or higher between 1969 and 1974. Through 1973 and 1974, trade unions continued to demand high wage increases and went on strike to improve their standard of living despite the government and the Bundesbank adopting a tight fiscal and monetary policy stance²³. Hourly wage increased by 12.8% in 1973 and by 14.8% in 1974, while the rate of wage raise in 1972 was 9.8%²⁴. In the 1974 wage bargaining round, the Union of Transport and Public-Service Workers (ÖTV) especially demanded huge wage increases. It was not until 1975 that its rates began to fall.

From international and comparative perspectives, a different result can in fact be observed. Table 6 shows that in Germany the average rate of wage growth between 1973 and 1980 is much lower than that in the other countries. For example, in Britain, weekly earnings (manufacturing) increased by 13.0% in 1973, by 16.8% in 1974, and by 26.3% in 1975²⁵. Compared to these figures, it is obvious that Germany has recorded relatively low rate of wage growth from 1973 to 1975. Nevertheless, the gap of the rates among these two countries in 1973 and 1974 was still small, and it was in 1975 that it started to be widened clearly as mentioned above.

Wage moderation in 1975 might be interpreted as a reaction to the serious recession and the rapid increase in unemployment rate in this period, because wage moderation

²² In the guideline, the Federal Government announced that the appropriate growth rate of wage in 1967 was 3.5% (4.0-5.0 in 1968).

²³ The number of participants in strike was 179,000 in 1973, 250,000 in 1974, while its number was only 23,000 in 1972. Refer to Statistisches Taschenbuch 2007.

²⁴ Its rate in 1975 was 9.4%. Refer to Statistisches Taschenbuch 2007.

²⁵ Refer to OECD Historical Statistics 1969-1988.

Table 3. Wage Bargaining (Metal Industry and Steel Industry)

Metal industry		Steel industry	
1969-9	8%	1969-9	11%
1970-10	15.3%	1970-10	10%
		1971-10	10.5%
1972-1	7.5%		
1973-1	8.5%	1973-1	9.2%
		1973-12	11%
1974-1	11.6%	1974	9%
1975	6.8%	1975	5%
1976	5.4%	1976	6%
1977	6.9%	1977	4%
1978	5%	1978	4%

Source: Thelen (1991:97, 113).

Table 4. Rate of Growth in Hourly Wages in Industrial Countries

	Manufacturing industry				Food, Beverage and Tobacco industry			
	Britain	Italy	Germany	France	Britain	Italy	Germany	France
60-67 average	4.9	8.7	7.5	7.1	5.2		7.6	7
67-73 average	10.4	13.3	9.1	11.9	9.8	14.4	8.8	11.9
73-80 average	17.2	22.2	7.1	14.9	16.5	19.4	7.5	15.7
	Chemical industry				Metal industry			
	Britain	Italy	Germany	France	Britain	Italy	Germany	France
60-67 average	5.1		8.6	7.1	4.7		7	7
67-73 average	13	13.6	10.2	12.1	10.3	12.5	9	12.2
73-80 average	17.3	20.6	7.1	14.5	17.5	22	6.9	14.2
	Textile industry							
	Britain	Italy	Germany	France				
60-67 average	5		7	7.3				
67-73 average	10.9	13.4	9.5	12.5				
73-80 average	17	23.3	7.2	14.4				

Source: OECD Economic Outlook, Historical Statistics.

should be more or less automatic when unemployment was high²⁶. Nevertheless, given the fact that not only Germany but also most of the other industrial countries suffered serious recession and sharp rise in unemployment, and the other fact that wage moderation could be observed only in Germany in the mid and late 1970s as Table 6 illustrates, it is obvious that wage moderation in 1975 cannot be explained only by them²⁷.

Therefore, the fiscal and monetary policy stances started to be tighter in 1973, and

²⁶ It can be argued that the purpose of a policy of wage moderation can change as economic situation changes, so in the early 1970s, wage moderation was required for fighting inflation, and after 1975 it was required for overcoming recession and unemployment problems. Refer to Scharpf (1978:14).

²⁷ For example, the rate of growth in GDP in Britain was -1.0% in 1974, while that in Germany was +0.1%. In addition, that in Italy was -3.6% in 1975, while that in Germany was -1.3%.

then the rise in inflation rate came to be moderated, while it was in 1975 that trade unions fully returned to a policy of wage moderation. Here, two further questions remain. The first question is whether or not the main participants, including wage bargainers, actually had the same view on the main policy goal and cooperated with each other to dampen inflation. Concerning policy assessment, scholars still have various insights. On one hand, Tietmeyer (1999) mentioned that anti-cyclical fiscal policy mostly failed to work because of various political difficulties. In addition, Hamori (1998) stated that inflation was dampened mostly by the unprecedentedly tight monetary policy, and Johnson (1998) maintained that fiscal measures at the time seemed insufficient to stop inflation's upward climb²⁸. On the other hand, Machida (1979) argued that not only monetary but also fiscal and exchange rate policy in 1973 fully worked to combat inflation, and then this seemed to be one of the most important participants which cooled off the economic boom. In addition, Schanetzky (2007) also mentioned that in 1973 the goal of monetary policy and that of fiscal policy were integrated into almost one, namely fighting inflation. Moreover, Barth (1980) estimated that inflation rate decreased by 0.08% in 1973 and by 1.15% in 1974 owing to the tight fiscal policy. However, such assessment of its fiscal policy has been carried out without sufficient examination of actual discussions on the principal policy objective among the main participants although this is still a debatable issue. It would be worthwhile further examining this matter, which will be revisited in section 3.1.

The second question is what motivated trade unions to restrain wage increases in 1975 although they demanded much higher wages than the government and the Bundesbank expected in 1973 and 1974. In other words, how did the government and the Bundesbank restrain huge wage demands instead of using the guidelines for wage bargaining which have been provided since the Stability and Growth Act came into force as a weapon in fighting inflation. Wage moderation can be one of the factors which help decreasing inflation rate, so answering the question above is also important for achieving the aim of this article. The historical process will be revealed in section 3.2 using primary sources.

3. POLICY COORDINATION AMONG THE PARTICIPANTS IN FIGHTING INFLATION

3.1. *Policy Coordination in a High Inflationary Period*

It is often said that the shift of Germany to the floating exchange rate system in March 1973 allowed the Bundesbank to be freed from external constraints, but in the 386th meeting of the Central Bank Council held just after its shift, the freedom was regarded as only temporary²⁹. At that time, the Bundesbank had already begun tightening the monetary policy. In the meeting, the President of the Bundesbank, Dr. Klasen expressed his appreciation to Pöhl for his cooperative attitude towards its tight monetary

²⁸ Kondo (2009) mentioned that the policy mix implemented by the economic actors in Germany during the 1973 energy crisis was not optimal. Refer to Kondo (2009: 56).

²⁹ Protokoll der 386. Sitzung des Zentralbankrats der Deutschen Bundesbank in Frankfurt am Main, HA Bbk, B330.

policy stance. The President of State Central Bank in Hessen criticized the extremely tight monetary policy, but Pöhl estimated that currency crisis at the time would come to limit the power of monetary policy again and the Bundesbank could only enjoy its freedom from external constraints for a very short time. Then, Pöhl also pointed out that the monetary policy stance was not too tight and the Bundesbank had to take the chance. Given such circumstances, it is easy to assume that all the anti-cyclical measures, including fiscal policy, were still indispensable for fight against inflation.

In this context, the two economic stabilization programs were carried out and the German Trade Union Federation (DGB) and the Bundesbank showed a favorable attitude towards these programs. Firstly, the President of DGB, Heinz-Oskar Vetter wrote to Hans Friderichs, the Minister of Economics, and the Federal Chancellor Willy Brandt in April 1973³⁰. In this letter, they asked the government to pursue an extra stabilization program because rise in inflation had not been stopped despite the unions moderating wage developments. For example, DGB suggested that the government should increase the amounts of federal stability loans and suspend the depreciation.

Similarly, in the 387th meeting of the Central Bank Council held in May 1973, some members stated that the government needed further monetary restraint³¹. According to Dr. Klasen, the Federal Ministry of Finance was fully supportive of an idea that Germany was faced with serious inflation, so tighter monetary policy stance had to be adopted. In addition, he thought that the increase in discount rate and Lombard rate by 1% could be acceptable to the Ministry of Finance³². Moreover, some members mentioned that it was extremely important to recommend that the Federal Government should use up all the usable anti-cyclical fiscal measures, such as 1) limiting credit to the federal, Länder and local governments, 2) establishing special deposits, and 3) reducing the amount of local bonds. Furthermore, Dr. Helmut Schlesinger suggested that the government should impose stability surtax not only on people in the upper income brackets but also on people in the middle income brackets in order to drastically decrease private consumption.

The first economic stabilization program enabled the government to impose a surtax on married couples whose incomes were more than 200,000DM and also on singles whose incomes were more than 100,000DM. Then, on May 9th, just six days after the meeting, the government announced the second economic stabilization program, which allowed the government to impose surtax on married couples whose incomes were more than 48,000DM and also on the singles whose incomes were more than 24,000DM. It seemed that certain opinions of the Central Bank Council were reflected in the second economic stability program. The important point here is that the government could

³⁰ BArch, B102/136772, Düsseldorf, 17. April 1973.

³¹ Protokoll der 387. Sitzung des Zentralbankrats der Deutschen Bundesbank in Frankfurt am Main, HA Bbk, B330.

³² In the meeting of the Central Bank Council, Dr. Klasen referred to an exchange with the Federal Chancellor, Helmut Schmidt and Pöhl. Then, he emphasized that the government strongly hoped that the Bundesbank would maintain its tight policy stance. Refer to Protokoll der 389. Sitzung des Zentralbankrats der Deutschen Bundesbank in Frankfurt am Main, HA Bbk, B330.

change the contents of the program to fight inflation although there seemed to be a great possibility of DGB opposing such a change.

Naturally enough, its change was favorably impressed by members of the Central Bank Council and surprisingly, DGB also regarded it as an acceptable change³³. According to a document about the prior consultation between Friderichs and principal wage bargainers for the meeting “Konzertierte Aktion”, the wage bargainers highly appreciated the second economic stabilization program in that it would not harm the incomes of a large part of the population and accepted the basic principles of the program although DGB, the Federation of German Industries (BDI) and the German Employer’s Association (BDA) did not necessarily show a favorable attitude towards the idea that people in the middle income brackets came to be taxed³⁴.

Considering those reactions of the participants to the economic stabilization programs, especially to the stability surtax, their actions seemed to be well-coordinated to fight inflation. In addition, there are records that prove the government to be cooperative towards the Bundesbank, in a document which Dr. Schlesinger sent to Helmut Schmidt, the Minister of Economics and Finance, in November 1972³⁵. The contents of the document were mainly about the abolition of special tax treatments and subsidies. According to the document, in the meeting of the Central Bank Council held in September 1972, the Ministry of Economics and Finance asked the Bundesbank to answer the question, what kind of special tax treatments and subsidies should be abolished to improve the German financial conditions. Then, the Bundesbank chiefly proposed that the government should abolish or restrict special tax treatments and subsidies especially for housing and construction. The Bundesbank estimated that the financial burden on the Federal Government due to such special treatments amounted to 4.75 billion DM, and its total, including the burden on the Länder and local governments, amounted to 11 or 12 billion DM in 1972. In short, the Bundesbank thought that the restriction of subsidies for housing and construction should definitely ease the financial burden.

The important point here is that the Bundesbank gave advice to the Ministry of Economics and Finance, which could also be beneficial to the Bundesbank itself to accomplish its task of price stability, when Germany had an urgent need to deal with inflation’s upward climb. Subsequently, the economic stabilization programs which were introduced by the government after the Bundesbank gave such advice, included the restriction of special treatments for housing and construction, such as temporal suspension of special depreciation on new houses.

Therefore, the government could carry out the economic stabilization program without hostile oppositions by the wage bargainers, which often kept fiscal policy from

³³ Yet, most of the members estimated that in order to reduce investment demands with the anti-cyclical fiscal measures of the second economic stabilizing program, such as temporal suspension of depreciation and increase in investment tax by 11%, such a tight fiscal policy stance had to be maintained for not shorter than two years. Refer to Protokoll der 388. Sitzung des Zentralbankrats der Deutschen Bundesbank in Frankfurt am Main, HA Bbk, B330.

³⁴ BArch, B102/136772, IA 1-02 04 02/2, Bonn, den 11. Mai 1973.

³⁵ HA Bbk, B330/10913-1.

working as an anti-cyclical measure, and the government and the Bundesbank cooperated to combat inflation together in this period³⁶. Then, in the 403rd meeting of the Central Bank Council held in January 1974, Dr. Klasen and Dr. Schlesinger mentioned that a large part of the participants in the “Konzertierte Aktion” meeting held in Bonn the day before, agreed in maintaining that Germany succeeded in easing the overheated economy with monetary and fiscal policies³⁷.

3.2. *What led to Wage Moderation in 1975?*

Restrictive fiscal and monetary policy cooled the economic boom, and thus Germany could attain a relatively low inflation rate owing to the efforts in 1973 and 1974. Yet, in spite of such effort and result, wage increases were much higher than the government and the Bundesbank expected until 1974. For example, in the 1974 wage bargaining round, ÖTV demanded 1) a wage raise of 15%, 2) vacation pay (Urlaub Geld) 300DM, and 3) 50DM for all of the children (Kindergeld)³⁸. This implies that such fiscal and monetary policy could not meet the unions’ demands at the time. In addition, the public opinion poll taken by the Bundesbank showed that unemployment has come to be a more important political issue than inflation for the German people since the 1970s³⁹. This suggests that recession in 1974 and the further aggravation of the unemployment problem in 1975 forced Germany to change its restrictive policy stance to gain social credibility. In this context, both the government and the Bundesbank actually implemented new measures⁴⁰.

First, fiscal and social policy in 1975 was carried out in accordance with such unions’ interests. As Table 7 demonstrates, there was a massive increase in expenditure and a decrease in revenue due to the recession and the tax reform in 1975. Social expenditure especially ballooned. From 1974 to 1975, expenditure on social security and unemployment benefits has risen by 39.2% and that on family and youth service by 235.4%. From an international and comparative perspective, social security spending in Germany increased from 24.7% of GDP in 1974 to 29.7% of GDP in 1975, whereas that across EUR 12 expanded on average by only 0.1%⁴¹. In addition, the amount of government subsidies, which were transferred into the receipts of social budget (Sozialbudget), grew by

³⁶ At least until December 1973, the government regarded fighting inflation with the Bundesbank as a priority matter. Refer to Protokoll der 389, 393, 394, 397, 398. Sitzung des Zentralbankrats der Deutschen Bundesbank in Frankfurt am Main, HA Bbk, B330. Certainly the government decided to abolish the investment tax and to readopt depreciation in December 1973 although a large part of the members of the Central Bank Council strongly opposed to this decision in the 402nd meeting. However, as Table 4 demonstrates, the cost of approved building did not increase soon after this decision was made, and in addition the government kept increasing the amount of special deposits at the Bundesbank even after December 1973.

³⁷ Protokoll der 403. Sitzung des Zentralbankrats der Deutschen Bundesbank in Frankfurt am Main, HA Bbk, B330.

³⁸ Refer to “Solidarität”, No. 67, März 2008.

³⁹ Refer to Johnson (1998:101).

⁴⁰ In September 1974, the number of the unemployed was 557,000, but it has doubled by the end of the year. After all, it reached 1,184,000 in February 1975.

⁴¹ Its share has increased by 1.3% (18.8%→20.1%) in Britain, and by 2.4% (20.5%→22.9%) in France. Refer to Statistisches Taschenbuch 2007.

21.1% during the same period, while employer's contributions increased by 6.7% and insured person's contributions by 10.2%⁴². As a result of this dramatic hike, the share of the government subsidies in the receipts of the social budget reached 38.1% and became larger than that of employer's contributions (36.5%) in 1975.

Table 5. Revenue and Expenditure of the Federal Government (Mio DM)

	Revenue		Expenditure			
	Total	Tax	Total	Social expenditure		
				Total	Social security, Unemployment	Family, Youth
1972	106338	101706	111086	31239	13928	4226
1973	119177	114958	122557	32165	14752	4077
1974	123572	118663	134035	38065	18787	4217
1975	123788	119210	156894	57051	26145	14145

Source: Finanzbericht 1984.

It was the Federal Labor Office (BA) that offered a broad range of services on the labor and training market for citizens in Germany. In addition, it disbursed child benefit as family benefit office, and its expenditure had been financed only through its own revenue until 1974. Yet, in 1975, it had no choice but to be financially supported by the Federal Government according to Clause 2, Article 187 of the Employment Promotion Act owing to the aggravation of the unemployment problem and to the tax reform in 1975⁴³. As Table 8 illustrates, the Federal Government liquidity assistance required by BA amounted to more than 7.2 billion DM, in 1975.

As mentioned above, not only the high increase in the unemployment rate but also the tax reform in 1975 made great contributions to the rapid increase in social security spending. Yet, this reform was not necessarily aimed at dealing with this temporal unemployment issue⁴⁴. The Social Democratic Party (SPD) has prepared the way for this reform for a long time, and the tax reform was the most important reform plan for SPD at the time. In fact, in October 1969 and January 1973, Willy Brandt explained the importance of the reform, and in May 1974, Schmidt reemphasized it in government statements. The principal purpose of this reform was to establish a fairer distribution of tax burdens among tax payers (Mehr Steuergerechtigkeit). Among SPD members, "a fairer distribution of tax burdens" was interpreted as the imposition of lighter tax burden on workers and medium-to-small self-employed workers, and that of relatively heavy burden on the high income earners.

The most important part of this tax reform in 1975 was the child benefit reform (Kindergeldreform). The law of child benefit was passed in August 1974, and child

⁴² Refer to Statistisches Taschenbuch 2007. Social budget is a biannual report, published by the Federal Government, on recent and projected expenditures and revenues of social security.

⁴³ Refer to Schmid, Günther, and Oschmiansky (2008: 349).

⁴⁴ AdSD, 2/BTFG 002766, zur Steuerreform (materiell), 14, August 1974. Basically, the main task of the tax reform was tax reduction for workers.

Table 6. Cash Receipts, Expenditure and Assets of BA

Mio DM		1973	1974	1975
Receipts	Total	7469	7986	16516
	Contributions	5829	6444	7787
	Federal Government liquidity assistance			7282
Expenditure	Total	6807	10353	17836
	Unemployment benefits(1),(2)	1577	4452	10749
Assets(3)	Total	5912	3586	2325

Source: Monthly report of the Deutsche Bundesbank 1976 Dec.

(1) Including compensation for closure or short-time working; from 1967 including follow-up unemployment assistance (2) Including contributions and reimbursements to health insurance institutions (3) At end of the year or quarter.

benefit started to be granted for all the children until the age of 18 on 1 January, 1975⁴⁵. Under certain circumstances, it can be paid for a longer period⁴⁶. People need permission by a department of a labor exchange (Arbeitsamt) to be entitled to it, and it can be paid via the Central Office of BA in Nürnberg. Before the reform, people who had only one child could not receive it, but they came to be able to obtain 50DM per month because of this reform. The amount (per a month) of the benefit for further children was also raised. Its amount for the second child increased from 25DM to 70DM, that for the third and the fourth child rose from 60DM to 120DM and that for any further children increased from 70DM to 120DM. As Table 9 demonstrates that total amount of child benefit (3,243 million DM→11,828 million DM), the number of recipients (2,457,000→7,333,000) and the number of Children who could be entitled to child benefit (5,196,000→14,065,000) have dramatically risen⁴⁷.

With regards to the effect of this tax reform, the government estimated that it would have two important impacts as Table 10 illustrates⁴⁸. The first impact was that whether high income earners or low income earners, tax burdens on all the people should be lightened. The second impact was that the tax burdens on lower income earners should be reduced much more sharply than those on higher income earners. The question here is whether or not SPD could actually meet the demand of trade unions, and foster

⁴⁵ Gesetz zur Reform der Einkommen steuer, des Familienlastenausgleich und der Sparförderung (Einkommensteuerreformgesetz-EstRG) vom 5. August 1974.

⁴⁶ When children were in school or received occupational trainings, they until the age of 27 were entitled to child benefit in 1975.

⁴⁷ Instead of such benefits, the tax allowance was certainly abolished in this reform. Before the reform, people who have children are entitled to tax allowances. The amount of the tax allowance for the first child was 1,200DM, for the second child was 1,680DM and for the third and any further children was 1,800DM. However, even considering the impact of the abolishment of the tax allowance, the government estimated that the tax reform would make the distribution of tax burdens "fairer" as Table 10 demonstrates.

⁴⁸ The figures in Table 10 were all estimated numbers. Some newspapers regarded this tax reform as failure, because this reform might have increased tax burden on a part of people, such as who divorced or retired early. However, it is, at least, the fact that most of the people were actually benefited by this reform. As for the newspaper criticism, refer to "der Spiegel" No. 6/1975.

Table 7. Child Benefit before/after 1975 Reform

	1974(before reform)	1975(after reform)
Amount/month		
child 1		50DM
child 2	25DM	70DM
child 3	60DM	120DM
child 4	60DM	120DM
child 5~	70DM	120DM
Total amount	3243MioDM	11828MioDM
Recipient	2457000	7333000
Children	5196000	14065000
Tax allowance	Yes	No

Source: Statistisches Taschenbuch 2007.

unions' loyalty to the government through this reform⁴⁹. According to a report about the wage bargaining of ÖTV in 1975, it was estimated that the tax reform directly increased the levels of their income by 3% on average⁵⁰. In addition, as mentioned above, it was ÖTV that demanded 50DM for all of the children in the 1974 wage bargaining round. Concerning its treatment for children, it seems that benefit caused by the 1975 tax reform was larger than ÖTV had demanded. As a result of such effort, it finally made a mediation agreement on 12th December, 1974 and it mentioned that it did not plan to go on a strike in 1975 unlike the previous year. In addition, rate of wage growth of ÖTV in 1975 dropped to 7.5%, while it was 12.1% in 1974⁵¹.

These facts above indicate that ÖTV would have started to restrain its wage raise because the effect of this tax reform in 1975 seemed to be able to offset a decline in its living standard due to its own wage moderation. As mentioned before, wage moderation could be automatic if unemployment was high, but it is obvious that such reform provided further motivation to moderate its wage demand for ÖTV. However, it is also the fact that as a result of this tax reform and the recession, the rate of growth in the Federal Government's debt, after all, reached 46.6% in 1975, while its rate was 9% in 1973 and was 15.2% in 1974⁵². Consequently, fiscal policy itself was really expansive throughout 1975, but simultaneously it contributed to wage moderation to some degree.

Secondly, as for the monetary policy, the Bundesbank was in a dilemma about policy stance to take. On the one hand, it had to deal with inflation which was still high compared to that in the 1960s and the 1970s and could rise again if monetary policy turned to be expansive, because its top political priority was maintaining price stability.

⁴⁹ One of the possible factors which motivates trade unions to cooperate with the government and adhere to the guideline for wage bargaining can be unions' loyalty to the government. Concerning the factors which stimulate the willingness of trade unions to cooperate with the government in wage bargaining, refer to Michael Hudson (2007:10).

⁵⁰ BArch, B102/136774, IC5 – 18 99 21/6 and 24 00 76/7, Stand der Tarifverhandlungen im öffentliche Dienste und in der Metall industrie, Bonn, 8. Januar 1975.

⁵¹ Refer to Deutschmann and Schmiede (1983:268).

⁵² Refer to Sachsteandigenrat, Jahresgutachten 1991/92.

Table 8. Distribution of Tax Burdens among Tax Payer before and after the Reform (Plan)

	Single, under 50, no child					Single, under 50, 1 child			
	[A] before reform	[B] after reform	[B]-[A]	[(B)-[A])/[A]		[A] before reform	[B] after reform	[B]-[A]	[(B)-[A])/[A]
8400	815	554	-261	32.0	8400	353	-600	-953	270.0
12000	1467	1201	-266	18.1	12000	957	-59	-1016	106.2
14400	1991	1696	-295	14.8	14400	1374	376	-998	72.6
18000	2924	2442	-482	16.5	18000	2094	1116	-978	46.7
24000	4916	4076	-840	17.1	24000	3874	2338	-1536	39.6
30000	7125	6206	-919	12.9	30000	5936	4206	-1730	29.1
36000	9537	8568	-969	10.2	36000	8256	6430	-1826	22.1
48000	14676	13762	-914	6.2	48000	13281	11451	-1830	13.8
60000	20143	19272	-871	4.3	60000	18680	16882	-1798	9.6
80000	29757	28967	-790	2.7	80000	28222	26487	-1735	6.1
100000	39661	39154	-507	1.3	100000	38077	36565	-1512	4.0
	Single, under 50, 2 children					married, under 50, no child			
	[A] before reform	[B] after reform	[B]-[A]	[(B)-[A])/[A]		[A] before reform	[B] after reform	[B]-[A]	[(B)-[A])/[A]
8400	-255	-1440	-1185	464.7					
12000	298	-899	-1197	401.7	12000	1036	488	-548	52.9
14400	703	-464	-1167	166.0	14400	1402	924	-478	34.1
18000	1355	210	-1145	84.5	18000	2016	1570	-446	22.1
24000	3038	1411	-1627	53.6	24000	3112	2652	-460	14.8
30000	5067	3247	-1820	35.9	30000	4492	3932	-560	12.5
36000	7294	5300	-1994	27.3	36000	6092	5186	-906	14.9
48000	12236	10251	-1985	16.2	48000	10155	8590	-1565	15.4
60000	17552	15664	-1888	10.8	60000	14613	12836	-1777	12.2
80000	27028	25243	-1785	6.6	80000	22787	20982	-1805	7.9
100000	36878	35303	-1575	4.3	100000	31540	29862	-1678	5.3
	married, under 50, 1 child					married, under 50, 2 children			
	[A] before reform	[B] after reform	[B]-[A]	[(B)-[A])/[A]		[A] before reform	[B] after reform	[B]-[A]	[(B)-[A])/[A]
12000	820	-112	-932	113.7	12000	200	-952	-1152.0	576.0
14400	1184	324	-860	72.6	14400	566	-516	-1082.0	191.2
18000	1744	970	-774	44.4	18000	1124	130	-994.0	88.4
24000	2822	2052	-770	27.3	24000	2440	1212	-1228.0	50.3
30000	4054	3266	-788	19.4	30000	3596	2360	-1236.0	34.4
36000	5558	4534	-1024	18.4	36000	4980	3628	-1352.0	27.1
48000	9490	7906	-1584	16.7	48000	8654	7002	-1652.0	19.1
60000	13865	11930	-1935	14.0	60000	12940	10926	-2014.0	15.6
80000	21965	20004	-1961	8.9	80000	20941	18816	-2125.0	10.1
100000	30667	28890	-1777	5.8	100000	29575	27678	-1897.0	6.4
	married, under 50, 3 children								
	[A] before reform	[B] after reform	[B]-[A]	[(B)-[A])/[A]					
12000	-850	-2392	-1542	181.4					
14400	-486	-1956	-1470	302.5					
18000	62	-1310	-1372	2212.9					
24000	1042	-228	-1270	121.9					
30000	2132	920	-1212	56.8					
36000	3440	2122	-1318	38.3					
48000	6908	5500	-1408	20.4					
60000	10969	9438	-1531	14.0					
80000	18854	17056	-1798	9.5					
100000	27443	25896	-1547	5.6					

Source: AdSD, 2/BTFG 002539, Brief von Dr. Katharin Focke, Bundesminister für Jugend, Familie und Gesundheit an die Mitglieder der SPD Fraktion im Deutschen Bundestag, 31, Juli 1974.

On the other hand, it had no choice but to ease its policy stance to some extent to lower unemployment rate because unemployment started to be recognized as more important political issue than inflation by the German people at the time. It is said that a new monetary measure, monetary targeting, which was adopted in December 1974, could be the way out of this dilemma as it would play a role in announcing the relaxation of monetary policy stance on the one hand, and would also play a role in announcing

the intention that the Bundesbank would never allow the central bank money to expand excessively on the other hand⁵³.

Specifically, the monetary targeting is a measure which was adopted not to give an impression that the Bundesbank deviated from its stable monetary policy stance on the wage bargainers, and not to stimulate inflationary mind when its policy stance needed to be relaxed. Theoretically, announcing that the Bundesbank will maintain its tight monetary policy stance should promote wage moderation, because wage bargainers do not have to be concerned about possible wage loss due to inflation if its announcement is trustworthy. In this sense, the monetary targeting could be one of the crucial factors which stimulated trade unions to return to a policy of wage moderation if its announcements were credible. The credibility of its announcements should depend on 1) whether unions regarded the target as an important factor in wage bargaining, 2) how the Bundesbank reacted to the government's expansive policy, 3) whether its monetary policy stance at the time was tight or expansive, and 4) whether it could actually control the growth for central bank money through obeying rules set by it.

Concerning the first point, it is said that officials of the member unions who took part in wage bargaining reject the idea that the targets played any roles in wage negotiations, either directly or indirectly⁵⁴. Next, with regard to the second, the third and the fourth point, it is necessary to observe how the Bundesbank, in reality, dealt with plural problems, unemployment and inflation. This will be discussed below.

In the 429th meeting of the Central Bank Council held in January 1975, the members of the Central Bank Council debated with the guest participant, Pöhl over financial issues⁵⁵. The amount of the Federal Government's debt was predicted to increase massively in 1975, so Dr. Heinrich Irmeler, a member of the Central Bank Council, stated that it might be inevitable for Germany to pursue shorter-term financing on a large scale, to solve the financing problem with controlling the growth for central bank money properly. In addition, Pöhl emphasized that further decrease in interest rates was essential because this decision could stimulate investments and lighten the burden on the participants owing interest payment although this advice was not given to lighten the burden on the governments.

In the 430th meeting of the Central Bank Council held soon after the previous meeting, the members decided to decrease discount rate and Lombard rate by 0.5%⁵⁶. Nevertheless, some of the members still regarded decrease in discount rate as problematic, because such decision might expand the volume of central bank money excessively. One of them emphasized that such decision would give the impression that the Bundesbank changed its tight monetary policy stance on the wage bargainers.

Since then, discount rate and Lombard rate have been decreased one after another.

⁵³ Refer to Hagen (1999:424).

⁵⁴ Refer to Johnson (1998:100). With regard to this point, further examination is still required.

⁵⁵ Protokoll der 429. Sitzung des Zentralbankrats der Deutschen Bundesbank in Frankfurt am Main, HA Bbk, B330.

⁵⁶ Protokoll der 430. Sitzung des Zentralbankrats der Deutschen Bundesbank in Frankfurt am Main, HA Bbk, B330.

Under such circumstances, the decision started to be made with the intention of making it easier for the governments to finance. In the 442nd meeting of the Central Bank Council held in August 1975, the members debated with the guest participants, Dr. Hans Apel, the Minister of Finance, and Pöhl over financial and monetary issues including open market operation which the Bundesbank started in the end of July⁵⁷. Dr. Apel mentioned that the Federal Government had to issue a large amount of securities in the second half of this year because of a shortage of tax revenue and financial resources of BA. In this context, the Central Bank Council decided to decrease discount rate and Lombard rate again and to continue a buying operation⁵⁸. Support was unanimous for the continuation of the buying operation, and all the members thought rise in yield of bonds had to be avoided with its operation.

Yet, it was doubtful if its operation had a certain impact on the yield of bonds. In the 444th meeting of the Central Bank Council held in September 1975, Dr. Schlesinger maintained that the gap between the yield of securities which were not assisted through "Support Buying" and that of the Federal Government securities did not seem to be widened although the amount of securities acquired by the Bundesbank accounted for about 12% of the total amount of the current Federal Government securities⁵⁹. However, the buying operation had been continued until the end of October 1975, and as Table 11 demonstrates, the amount of securities accepted by the Bundesbank reached about 7.5 billion DM in 1975, while it was normally small. It had increased dramatically within 4 months, between the end of July and the end of October, and after all it came to account for 20.8% of the total amount of the current Federal Government securities⁶⁰.

Table 9. Acquisition of Securities by the Bundesbank (Mio DM)

1961	15	1966	-8	1971	13
1962	-101	1967	1251	1972	-359
1963	-50	1968	-404	1973	-28
1964	-35	1969	-467	1974	444
1965		1970	-73	1975	7490

Source: Deutsches Geld- und Bankwesen in Zahlen 1876-1975, Monatsberichte April 1976.

It is not obvious how much impact this operation had on the yield of the Federal Government securities, but at any rate the government ended up having to be interpellated about this buying operation by CDU/CSU in Federal Parliament⁶¹. In the

⁵⁷ Protokoll der 442. Sitzung des Zentralbankrats der Deutschen Bundesbank in Frankfurt am Main, HA Bbk, B330.

⁵⁸ Market operation was first introduced by the Reichsbank in 1901. Refer to "Die Zeit", 24 Nov 1967.

⁵⁹ Protokoll der 444. Sitzung des Zentralbankrats der Deutschen Bundesbank in Frankfurt am Main, HA Bbk, B330.

⁶⁰ Protokoll der 445. Sitzung des Zentralbankrats der Deutschen Bundesbank in Frankfurt am Main, HA Bbk, B330.

⁶¹ BArch, B126/65643, VII A1-62 00 00/4-7/75, VII A2-Su 3010-57/75, Bonn, den 31. Oktober 1975.

question-and-answer session, questioners often used the concept, "Support Buying (Stützungskäufe)", and it means that CDU/CSU might regard the open market operation as granting of credit from the Bundesbank to the Federal Government. Two examples of question-and-answer will be mentioned below;

Q1. Does the Federal Government recognize that the Bundesbank evaded the rule, namely credit limit prescribed in the Bundesbank Law with the support buying? In addition, does the government have an insight that the amount of securities acquired through such an operation should be included in the credit limit⁶²?

A1. The Federal Government securities acquired through the open market operation would not be included in the limit. It has to be treated in such a way, because the money created through a buying operation does not flow into the issuer, but into the seller of the securities.

Q2. Does the Federal Government know that Dr. Klasen has declared in public that the Bundesbank would continue the support buying for the time being several times? Does the government have an insight that owing to such an operation the Bundesbank will abandon the direct control over the volume of central bank money, and then readopt its old measure to control the liquidity through changing interest rate.

A2. The Klasen's statement might give an impression that the Bundesbank would keep buying the government securities long enough to allow people to believe that the larger growth of liquidity was still desirable. However, the Bundesbank has already stopped buying them since the 22nd of October.

According to §21 of the Bundesbank Law, the open market operation has to be carried out primarily for maintaining the equilibrium of the financial market. Nevertheless, as shown above, this operation could work as "Support Buying" whether it is intentional or not⁶³.

Meanwhile, the introduction of monetary targeting has not been gaining enough support from the members of the Central Bank Council in the policy making process. In the 426th meeting of the Central Bank Council, Dr. Otmar Emminger, the Vice-President of the Bundesbank, opposed to the idea that the Bundesbank should announce a definite target rate of growth for central bank money. There were three reasons why he was concerned about it. The first reason was that the growth rate for central bank money did not always increase in proportion to a rise in GNP. For example, the growth rate for central bank money was only 7%, while the rate of growth in GNP reached 13% in 1970. The second reason was that technically it was too difficult for the Bundesbank

⁶² As for a credit limit, it is prescribed in §20 of the Bundesbank Law. Refer to Die Deutsche Bundesbank (1989).

⁶³ BArch, B126/65643, VII A1-62 00 00/4-7/75, VII A2-Su 3010-57/75, Bonn, den 31. Oktober 1975.

to achieve the goal. The third reason was that his ideal target growth rate was from 4.5–5.5%, whereas the actual target rate was set at 8% in 1975⁶⁴. In addition, some of the members did not have any clear reasons why they should support the adoption of the new monetary measure. They supported it just because with its measure they might be able to have a small possibility of succeeding in controlling its growth rate under unstable political and economic circumstances.

To sum up, the Central Bank Council came to pursue the monetary policy which was enough adventurous to give the impression that it was working as “Support Buying” although months before there was some cautious members who regarded even only 0.5% decrease in discount rate as problematic. After all, the actual growth rate for central bank money reached 10.1% in 1975 while the target rate was 8%⁶⁵. Moreover, the introduction of the monetary targeting was not fully supported by the members in the first place. Given these facts, the monetary policy, which was carried out after the introduction of the monetary targeting, was actually expansive, and it is doubtful whether with its new monetary measure the Bundesbank could have given the impression that it maintained its stable monetary policy stance on the participants. Hence, it is difficult to conclude that the introduction of the monetary targeting was one of the principal factors promoting wage moderation in 1975.

4. CONCLUSION

The points in this paper will be briefly summarized below. Firstly, until December 1973, the government could carry out the anti-cyclical fiscal policy to fight inflation without political oppositions, and even after December, it maintained its tight policy stance to some degree, and as a result of the policy coordination between the government and the Bundesbank, a number of political participants came to recognize in the early 1974 that the German economic boom had already been dampened. Secondly, when Germany was faced with recession and high growth of unemployment, both fiscal and monetary policy stances came to be relaxed to solve these problems. The government carried out the tax reform in 1975, including the child benefit reform, to establish a fairer distribution of tax burdens among tax payers, and this decision made up for losses which wage moderation generated. Meanwhile, the Bundesbank introduced the new monetary measure, monetary targeting, not to stimulate inflationary mind. Yet, given the fact that the Central Bank Council pursued the monetary policy which gave the impression that it was working as “a Support Buying”, and then the Bundesbank overshot its intended

⁶⁴ In 1974, the actual growth rate for central bank money was 6%.

⁶⁵ Some argue that the Bundesbank overshot its intended target for four straight years after the introduction of its new monetary measure, but it is not a big problem because it is commonly said that it intentionally allowed the growth rate for central bank money to overshoot its target. It practically tried to adapt to changing circumstances, so its policy stance and its measure were sometimes called “Practical Monetarism”. However, why in the world should it set the rule, monetary target although it cannot obey its own rule? In addition, as mentioned above, it was extremely difficult for it to control its growth rate properly. Hence, the fact was that it would be inevitable for it to allow its growth rate to overshoot its target because it could not fully control its rate. With regard to “Practical Monetarism”, refer to Hamori (1998).

target in the end, the monetary policy in this period was actually expansive. In addition, the introduction of the monetary targeting was not fully supported by the members in the first place. Finally, it is concluded that the monetary targeting did not seem to be one of the factors encouraging wage moderation, while the tax reform stimulated ÖTV to moderate wage increases to some degree.

Thus, policy making by both the government and the Bundesbank was well-coordinated not only in a high inflationary period but also in recession. This is totally different from static models that earlier literature in comparative political economy assumes. To account for variations in the economic performance, some recent studies put a special emphasis on various institutional characters which each nation has. For example, Cukierman, Webb and Neyapti (1992) and Alesina and Summers (1993) focused on the economic effects of central bank independence as briefly mentioned in the introduction of this article. Basically, both of them concluded that countries with a highly independent central bank can attain better inflation records. In addition, Bruno and Sachs (1985) and Tarantelli (1986) placed great emphasis on the economic effects of the coordination of wage bargaining. The point of this framework is that the degree of coordination mainly depends on the organizational structure for wage bargaining and the countries with well-coordinated wage bargaining institution tend to achieve better economic performance. Moreover, Hall and Franzese (1998) emphasized the importance of an interaction between the Bundesbank and wage bargainers. Concerning the German case, they maintained "the capacity of postwar Germany to secure low rates of inflation at low rates of unemployment cannot be attributed solely to the independence of the Bundesbank, but rather it derives from an effective signaling process that is based on a combination of central bank independence and coordinated wage bargaining"⁶⁶.

According to such theoretical explanations, Germany should be described as a country which has one of the most independent central bank with well-coordinated wage bargaining institution. Thus, theoretically, it can be argued that because of such institutional characters, Germany could achieve outstanding economic outcomes in the postwar period. In addition, these theoretical frameworks suppose that the government is a participant who tends to have a strong political influence on the central bank, and always tries to force it to pursue more expansive monetary policy. Nevertheless, it is obvious that unions claimed higher wages than the government and the Bundesbank expected in 1973 and 1974, and such studies also do not take into account the policy coordination between the central bank and the government. The government in fact carried out tight fiscal policy to combat inflation when Germany really needed to deal with inflation, and the Bundesbank actually eased its policy stance to support the government, when the decision seemed to be rational for the Bundesbank from political and economic perspectives. Hence, this paper clearly reveals what cannot be explained with these two prevailing institutional concepts, central bank independence and wage

⁶⁶ Refer to Hall and Franzese (1998:514).

bargaining institution⁶⁷. Specifically, this study describes that the government or the interaction between the government and trade unions can presumably contribute to wage moderation. This is a possible contribution of this article to the studies of earlier literature.

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