Why Reflation Won't Work In West Germany

French Prime Minister Barre's statement to the French daily *Le Figaro* last week that West Germany had experienced hyperinflation twice during this century and was not about to go that route again, was not an exaggeration to make a point. Even the Brookings Institution economists — the staunchest proponents of West German reflation to prop up the U.S. dollar — have recently admitted in private that the West German government cannot reflate much further without ruining the country's credit system.

The 10 percent increase in Federal government expenditures (less than 1 percent of Gross National Product) provided for under Chancellor Schmidt's "stimulation" budget for 1978 does not seem like much. However, since 1973, the economy of the Federal Republic (BRD) has *already* undergone an extremely rapid growth of public indebtedness to the detriment of industrial production and investment.

From the end of 1973 through March 1977, total public authority debt including the federal, state, and local government sectors, rose 82.2 percent, to the sum of $131 billion or nearly 12 percent of the country's GNP. Federal government indebtedness alone shot up 109 percent to $58.5 billion. During the same period, manufacturing output actually fell 2.1 percent (see article, this section). Every government "boost" package since the onset of the world depression in 1974-75 has merely tended to aggravate the shift of liquidity out of investment in basic manufacturing into government paper and other nonproductive financial speculations.

New Budget, New Deficits

According to BRD Finance Minister Hans Apel, the new "pump-priming" budget will result in a total public sector deficit of DM 47 billion in 1978, up from DM 33 billion, incurred in the 1975 depression year. Already, in September, the expectations of a higher budget deficit combined with reduced foreign capital inflows (due to the temporary dollar stability) and expanded lending to foreigners (required to bolster BRD exports) has forced the Bundesbank to inject new liquidity into the banking system.

While the 1978 budget deficit financing is unlikely to result in wholesale "crowding out" of the private sector from the capital markets — as occurred in 1975 — this is only because private corporations have already curtailed their capital spending. With existing industrial capacity grossly underutilized, investment in new plant and equipment is simply unprofitable; BRD firms have instead directed the bulk of their cash resources into purchases of high-yield government bonds or long-term bank certificates of deposit. The apparent "excess liquidity," resulting from this stagnation of investment, has brought federal government bond rates down as low as 6 percent this year, compared to 11 percent in 1974.

As Table 4 on page 6 shows, corporate purchases of bonds rose to nearly 90 percent from 1975 to 1976. The apparent stability in corporate deposits obscures the drop in demand deposits maintained by corporations with their banks for immediate spending purposes from DM 12.4 billion to DM 4 billion, while time deposits more than tripled from DM 4 billion to DM 12.8 billion. Corporate holdings of certificates of deposit (CD's) rose 36 percent in the same period, with long-term CD's (four years maturity or more) accounting for most of the rise. Long-term CD's jumped from 35 to 44 percent of the total corporate-held bank instruments.

In this way, vast sums of liquidity have been momentarily "sterilized" from circulation and redirected to financing government deficits or exported via foreign bank deposits on the burgeoning Eurodeutschemark market. The Bundesbank's "orthodox" monetary policies therefore appear to have successfully curbed money supply growth and brought the annual inflation rate down to 4 percent. In reality inflation, in the form of sprialing fictitious paper claims against a stagnating productive base has merely been "forced underground."

Corporate Losses

Moreover, BRD corporations, attempting to compete on world markets under conditions of a rising deutschemark exchange rate, have not been able to pass along their increased costs. They have consequently absorbed much of the inflation themselves in the form of reduced profits. According to a recent Commerzbank report, "on average the return on sales in the manufacturing industry will probably go down again to approximately 1.5 percent this year (against 1.7 percent in 1976); in other words, it will be far below the level of some 3.0 percent which was usual in the past and necessary, if capital spending is to be encouraged."

Another inflationary surge — brought on by government pumppriming — would cost BRD firms both their profits *and* their export markets. An aggravating factor is that, due to austerity conditions in other countries, BRD corporations have been forced to finance their own exports. Credit facilities provided by BRD firms to their foreign customers, often on very easy terms, ballooned by 143 percent from 1975 to 1976.

The truth is that despite tremendous injections of credit into the BRD economy since 1974, it is already sinking back into depression.

Virtually none of the BRD corporate credit expansion has been directed into manufacturing. Instead, installment loans and other types of consumer debt soared in order to finance an ephemeral auto boomlet.

Official figures for BRD credit to economic sectors show, for a January 1974-December 1976 period, that the percentage growth per annum has been the following:

Total private sector	+7.6%
Enterprises	+6.6%
— Manufacturing	+2.25%
Private individuals	+15.3%
— Installment credit	+22.3%

Bundesbank figures for 1977 indicate that this trend has worsened. At the end of March 1977, consumer credit had risen 20.5 percent from the 1976 level but bank lending to manufacturing was up only 6 percent on the year. Bank lending to the public sector continued to grow at 10 percent annual rates — faster than the private sector as a whole.

Meanwhile, the rapid growth of the Eurodeutschemark market primarily based in Luxembourg, represents a potentially dangerous inflationary cancer. Since 1969, the Eurodeutschemark pool has multiplied twelvefold from a mere \$3.9 billion to \$48.7 billion in 1976.

For all the above reasons, further internal "stimulus" programs cannot possibly revive the BRD economy but will only severely aggravate the already rapid decline of its industrial base. West Germany's main hope now lies in a reconstruction of the international monetary system to provide the context in which the country's capital goods exports can expand.

— *Alice Roth*

BRD: Industrial Colossus With Feet Of Clay

While the evident lag in the West German economy recently has led to redoubled calls from such U.S.-linked forces as trade union leader Eugen Loderer for massive government deficit spending to create make-work public jobs, analysis of the latest West German figures and trends appears to strongly bear out Chancellor Helmut Schmidt's insistence that no stimulation program of any size can take the place of a flourishing world market for West German industry.

Thus, while the disturbing decline in the rate of growth of the West German GNP was cited by Schmidt in proposing a modest reflation program of a 10 percent increase in the federal budget and cuts in personal and business income taxes recently (the Chancellor has also taken steps to enable local governments to get easier credit, though he has not given any money to this program), the total federal, state, and municipal government debt for 1977, DM 47 billion, is not organized to provide any such jobs at all.

It remains to be seen, however, what strategy the Schmidt government will adopt, beyond resisting British and Carter-Mondale Administration calls for world hyperinflation, to bolster West Germany's plodding performance in the anemic international industrial market.

Foreign orders, which account for 25 percent of the West German Gross National Product, decreased 4 percent in July, following a 6 percent decrease in June. Steel production in August was only 1.4 million tons, compared to a just as discouraging 1.51 million tons in August 1976. Incoming steel orders in August from European Economic Community countries decreased 42 percent and domestic steel orders dropped 8 percent compared to July.

This plunge in orders and production caused West German exports to decrease by .8 percent in July against June, although imports increased by 3.4 percent during the same month. A preliminary overview of import and export figures for August, however, indicates that both imports and exports dropped. This means that the decrease in West German exports to several key sectors since January (Table 1) is finally deepening to an overall export *and* import decrease, too. The export decline started with a fall off in orders from the weaker economies of Italy, France, Denmark, and the Third World, and as these countries form one-third of West Germany's total export market, the drop-off in exports indicates export markets are undergoing a dangerous contraction.

The dollar-debt overhang that is preventing West German trade from advancing was analyzed in a recent *Executive Intelligence Review* (Vol. IV, No. 37, "The Dilemma of East Bloc Debt") for the centrally planned economies. The decrease in exports, and its accompanying import decrease, will accelerate as corporations find that they are increasingly unable to either sell their products or pay for raw materials in the amount they were accustomed during this downswing.

As Table 2 shows, the world depression has collasped West German manufacturing as such a rate in the 1975-1976 period that manufacturing has done far worse than stagnate — it has actually decreased. The only sectors that have not decreased are the auto sector, whose products have been purchased through the issuance of disturbing quantities of consumer credit, and the electrotechnical sector, which has been helped by several one-shot sales such as the purchase of \$4 to \$5 billion worth of nuclear energy equipment by Brazil. The auto sector, with its feeble "boom" of a 2.2 percent increase in output from 1973 to 1976, is the sector cited by economic apologists as proof that collapsing world markets can be offset by increased domestic demand.

The real effect of the depression is best shown by the decreases in output in the basic producer, capital, and engineering goods sectors, the backbone of BRD in-