Only one way out of Bonn's debt plight

by Volker Hassmann and EIR Staff

"The Keynesian demand-side program 'German Unity' has fizzled out, the consolidation of national finances will be in the foreground for the rest of the decade." Nothing could better describe the dilemma of internal German economic and financial policy than this upshot from the conjunctural expert of the German Institute for Economic Research (DIW) Dr. Heiner Flassbeck, at a technical conference of the Social Democratic-linked Friedrich Ebert Foundation last November entitled "Financing German Unity." As with all programs of this sort, what is burning here is only a straw fire, the smoke of which makes people temporarily forget the economic catastrophe in the new states. The necessary targeted investment buildup for overall infrastructural development and setting up a sound small and middle-sized industrial sector remain remote. Western Germany finds itself in the worst recession since 1945, and the reigning economic wisdom consists of plugging holes in the budget. Any initiative for real economic development is stifled with the question: Where will the money come from?

Economic policy in Bonn is in shambles. The mass of national debt is growing daily. The latest Bavarian state central bank estimates, often taken as a forecast, are running toward a total debt at the end of 1993 of DM 1,670 billion or 55% of gross domestic product. Federal Germany's new debt is supposed to climb to DM 80 billion, double what Finance Minister Theo Waigel had planned.

Piled up debts

The real public debt burden becomes clear only when off-budget spending and the extraordinary budgets are figured in, such as: special reconstruction grants; the German Unity Fund; development credit funds like the Treuhand (the agency set up for converting the East German companies); rail, postal system, and the national development banks; and the cheap credit programs of the Credit Institution for Reconstruction, the German Settlements Bank, and the Berlin Industrial Bank. Besides these kitties are the indemnity funds (compensation for confiscations in the former German Democratic Republic) and a railroad fund (old debt from the federal rail system and the Reichsbahn). The strain on the capital markets for these is reckoned at DM 120 billion for 1992 plus DM 70 billion net credits received from federal, state, and municipal governments, giving a total new debt of DM 190 billion—70% of domestic savings.

The total debt, though, is higher. At the cited technical conference in Bonn it was figured at a minimum of DM 2.3 trillion by the end of 1995 ("interpreting the present prognoses benevolently") a debt ratio of 61% of GDP. What these figures still fail to reckon with is the recession, which leads to exploding social costs and tax revenue drops. In the next three years, conservatively, a DM 100 billion fall in tax revenues can be expected.

There is also a negative shift in financial flows. The massive capital transfer into the new states, which mainly went into consumption and not capital investment, turned Germany into a net capital importer. In 1989-90, DM 80 billion were still being invested abroad, but in 1992 domestic savings did not cover the cost of investments at home. A DM 45.6 billion gap had to be filled from foreign sources.

The austerity-based "Solidarity Pact" which the trade unions signed last year is more or less a dead letter. Chancellor Helmut Kohl has taken the financial policy reins in hand himself, and Waigel announced details of the program, which among other things projects deep cuts in social spending to the tune of DM 20 billion. When this packet is overhauled, the deficit is expected to be held to the present level. According to Waigel, this means goodbye to rising economic expectations.

When a government is forced to constantly revise upward its payments to the exploding national debt and the growing public deficit, normally the opposition's day has come. Indeed, pamphlets with speeches from Social Democratic think-tank conferences are streaming to editors' desks. In the last months there have been some sensible proposals from Social Democrats seeking alternative approaches to the rebuilding of the eastern German economy, such as former Labor Minister Ehrenberg's idea of a DM 100 billion infrastructure program. The problem is financing. Under free market liberal economic ideology no one dared violate the taboo against a return to creation of productive state credits, and the experts of the Friedrich Ebert Foundation foundered on the same shoals.

Disappointing balance

The peculiar dynamic of the German economic crisis lies, according to Dr. Flassbeck, in the fact that more and more western investors are pulling out from the east. In the "historically unique situation, that an economy shaken to the core like the east German one became an 'annex' to the west German economy, we can hardly afford a recession such as those we have experienced three times in the past 40 years." The much-discussed wage gap can, in Flassbeck's view, only be overcome if total per capita investment is heavily increased. What is key is not the level of wages in the east, but wages relative to output; labor costs go down as productivity goes up. Since investments are too low, productivity

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is limping so badly that, despite massive freeing-up of manpower, the wage bill in the east is climbing much faster than in the west.

Dr. Dieter Vesper from the same Berlin institute referred to the classic dilemma of liberal monetarist policy. National revenues drop in the crisis, and spending needs grow, and the financial gap widens. Programs for cranking up the real economy with government investments, which then raise the public deficit, fall victim to the credo of limiting the deficit. Vesper pointed out that cuts in social spending and public investment are most counterproductive in economic hard times, when a policy of support for labor must be deployed against the conjuncture. Public infrastructure, he added, not only stimulates private sector growth, but brings its own benefits in production and employment.

For eastern German transport routes alone some DM 185 billion needs to be spent. An energetic buildup of private economic and public capital stock in the east, estimates one economist, means an order of scale of over DM 2 trillion, DM 500 billion of it just for state-financed infrastructure (transport, energy, communications, housing, etc.).

Deficit spending or state credit creation?

Within prevailing market-economy logic a paradox enters when it comes to financing all these desirable programs. Expansive financial policies, hence state investments, which build up a conjuncture-conditioned deficit, cannot be enacted because of the dictates of the tight-money austerity policy. This contradiction lies behind the ultimate senselessness of "conjunctural programs" and "stimulus packets," which are supposed to be offset by the harshest austerity policies.

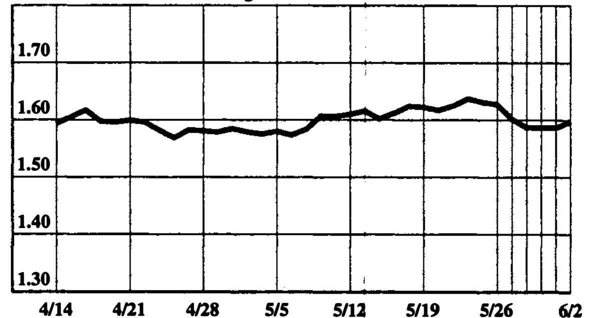
Now the trend is toward financing minimal necessary investment needs in the new states through tax and rate hikes. Cologne financial scholar Professor Dr. Marckscheidt emphasizes rightly that "state debt is something thoroughly positive, namely the evidence that the state has carried out public investments and hence has produced public wealth, of which the future can make use." But since 1990, the state has produced only "wealth for the present," i.e., consumption-oriented payment transfers to the east, defrayed by tax increases. So now, the deficit financing has to be stopped and compensated for by fiscal financing—which boils down to figuring out which new taxes and spending cuts can be sold to the voters.

All these considerations, whether from the regime or the opposition, block out the main point: that the massive infrastructure investments, which are surely needed, must be launched by state creation of productive credits via the regulated issuance of notes by a national banking system. As long as these credits are directed exclusively into real physical wealth production, they are not inflationary, because the resultant growth will generate rising tax revenues. A third way between "deficit spending" and state credit creation does not exist.

Currency Rates

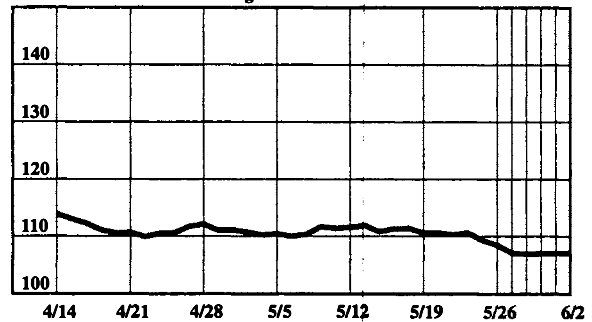
The dollar in deutschemarks

New York late afternoon fixing



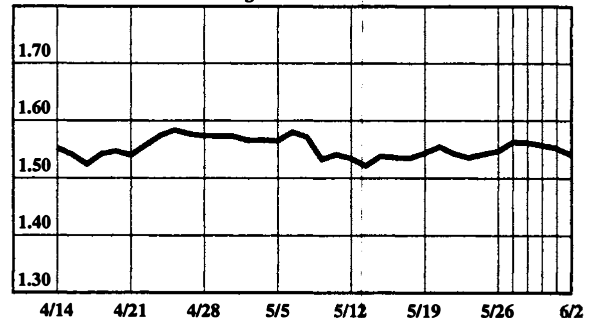
The dollar in yen

New York late afternoon fixing



The British pound in dollars

New York late afternoon fixing



The dollar in Swiss francs

New York late afternoon fixing