

CONFIDENTIAL

May 18, 1944

First Draft

RECOMMENDED POLICIES FOR THE
ALLIED MILITARY GOVERNMENT IN GERMANY

CONCERNING

1. MONEY, BANKING AND INSURANCE
2. THE PUBLIC DEBT
3. PUBLIC REVENUE AND TAXATION
4. PUBLIC EXPENDITURES

by

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Recommendations
concerning certain financial questions
confronting the Allied Military Government
of Germany

Introduction

The following four problems are discussed: What should the A.M.G. of Germany do with respect to

1. Money, banking, insurance
2. The Public Debt
3. Public revenue and taxation
4. Public expenditures and budget control?

The recommendations refer to A.M.G. only, that is to the short-run, a period of, say, six months to a year.

It is assumed that there will be an agreement between the occupying powers on the fundamental principles of policy, even if the military occupation is regionally divided between the Allies. The following proposals refer therefore to Germany as a whole. If different policies were adopted by the occupying powers for the different areas of occupation or if Germany was conquered piecemeal like Italy, the following recommendations would have to be modified.

The four questions are closely interrelated especially the first two and the second two. All of them are intimately connected with others with which we are not concerned here, for example, the chances of maintaining strict price and wage control and rationing and the determination of the external value of the Mark (Dollar-Mark exchange ratio). About some of these related issues we shall have to make certain assumptions, in order to have a basis on which to proceed.

First question: Money, banking, insurance

Objectives -- The objective of all measures of monetary and credit control will be the maintenance of an orderly monetary system as a prerequisite of a tolerably smooth functioning of the German economy. This implies the avoidance of a runaway inflation. It will be hardly possible to avoid price inflation altogether, but hyper-inflation as in 1921-23 must be avoided. And it should be clearly realized that today inflation would reach the stage of hyper-inflation much more quickly than after the last war.

Importance of direct controls for checking inflation -- In order to check inflation it will be absolutely necessary to maintain as far as possible price control, rationing and allocation in the sphere of consumption and production. But it is very doubtful whether it will be possible to

enforce direct controls to the necessary extent. The German administration will be purged, police power curtailed, regimentation loosened and the present discipline is likely to disintegrate. We should fool ourselves, if we did not anticipate such developments. The defeat will be a terrific shock to the whole people; it would be a miracle if war controls could be continued with the present efficiency and gradually relaxed. The victorious countries will be lucky if they can achieve a smooth and orderly transition for themselves. In a defeated, disorganized, dispirited country this is too much to expect.

If the direct controls break down it will be necessary to take very drastic monetary and financial measures to check inflation or to keep it at least in reasonable bounds. But even if direct controls are being maintained, drastic monetary measures will be required in order to supplement the direct control, to ease the pressure on them, counteract an anticipated decline in their efficiency and to pave the way for an eventual abolition of the direct controls.

Strict Control over the Reichsbank and the Credit System -- The most important prerequisite for any monetary policy is a firm control over the center and head of the German monetary and credit system -- the Reichsbank. The German money and banking system is highly centralized and the measures proposed below will make the banks and other financial institutions more dependent on the Reichsbank for liquid funds than they are now. Therefore, if the Reichsbank is under strict control, the whole banking and credit structure and to a large extent Government finance can be controlled.

Two Sources of Inflation -- Two kinds of inflation can be distinguished -- pent-up inflation and current inflation. Inflation threatens (a) from the loosening of the overhanging flood of liquid funds accumulated during the war and (b) from a current deficit of Government finance, excessive current bank credit extension to business and in general a current excess of money demand over the supply of goods -- a current inflationary gap. The current inflationary gap will be very serious in view of the fact that the available stocks of goods will be at an extremely low level and that current production, if it can be quickly started, will be heavily concentrated on physical reconstruction creating income without a counterpart in the form of consumable goods. The situation will be aggravated by any measures taken to export from Germany for relief and reparation purposes and relieved by imports into Germany, for example of the requirements of the occupation forces.

A.M.G. will have to deal with both sources of inflation. Accumulated liquid funds (cash, deposits, and other near-money assets) must be immobilized and current expenditures must be adjusted as nearly as possible to the flow of available goods.

How to Deal with Pent-Up Inflation -- In Germany as in the United States the monetary circulation has been almost quadrupled since the outbreak of the war and will go still higher until surrender. (For details see

Appendix) The flood of money has been dammed up by direct controls. In technical parlance, the velocity of money has been artificially reduced. People are forced to hold more money or money substitutes by the fact that there are no goods to spend on, and that rationing and price control prevent them from bidding up prices. If this dam, the direct controls, becomes leaky and begins to crumble, the dammed-up flood has to be removed if a general inundation, i.e. a runaway inflation is to be prevented.

Various measures could be taken to eliminate this danger. In selecting measures of different types and severity, two principles should be kept in mind: The measures should be rather too drastic than too mild, because it will make things much easier if the initial measures can be relaxed than if they have to be tightened. The measures should be as simple as possible; administrative feasibility must be an important consideration. It is true that any simple method must involve a certain degree of injustice, but an attempt to apply high standards of social justice to the problems of controlling the supply of money and deposits from the very beginning might involve delay in organizing the controls which would let inflation get out of hand. Later refinements will serve both to achieve greater justice and more effective control of inflation at one and the same time.

Alternative recommendations -- In the following we recommend three alternative schemes. Scheme A is crude and simple. Scheme C is more complicated, but if administratively feasible more effective. Scheme B is a compromise between A and C.

Provisions Common to Scheme A, B and C

All three schemes are designed first and foremost to prevent a runaway inflation in Germany after surrender and secondly, while maintaining precautions against long-run inflationary tendencies, to liberate sufficient purchasing power, to carry on trade and production without restraint, from the monetary side, upon a normal revival.

Bank holidays -- Probably all banks will have closed their doors voluntarily, but if not it will be necessary to proclaim bank holidays to avoid runs and to permit the organization of personnel, the publication of decrees concerning currency and deposits, and the preparation of forms. Once these administrative preparations are complete, the banks should be reopened as soon as possible in order to interfere as little as possible with ordinary economic life. When they reopen, the availability of deposits should be governed immediately by the rules selected from alternatives described below. If the banks reopen before the exchange of currency, which we treat presently, has been announced encashments should be made in the old money or at least not in the new money to be issued in the course of the exchange; if they are opened after the exchange of money has been started or announced, new money should be used. For reasons which will presently appear, it is necessary, on any of the alternative schemes for treating bank deposits, that the banks be reopened by the final date for converting currency to new issues.

Moratorium on private debt -- A complete moratorium on all debts including even rent due and the other small obligations is necessary during the bank holidays. When the banks are reopened, the moratorium should be relaxed to a degree compatible with whatever scheme is adopted for limited availability of deposits. Provision will need to be made for firms awaiting payment on cancelled government contracts, settlement of uncollectable foreign claims, etc. etc.

Exchange of currency -- In order to control the expenditure of cash (currency), large amounts of which will repose in the hands of businesses and the public generally, it is necessary drastically to reduce its volume and velocity of circulation. The only way to effectuate this with certainty is to provide a forced conversion to a new issue, since the presentation of the old issues for exchange into new offers the occasion for forcibly withholding a part of the money and for putting hoarded money under control, according to one or another of the schemes presented below.

It is of the utmost importance to carry through the exchange within a short time after occupation, preferably within a week or a fortnight at most, since, though deposits may be adequately controlled by the rules for transfer and encashment, the cash in the hands of the German public will be sufficient to drive a large price inflation.

Stamping of notes does not appear to be technically practicable because of the ease of falsification and because of the sheer magnitude of the physical operation (which has to be carried through manually) in a very limited time. Our recommendations as to the conversion therefore contemplate only newly printed notes.

These notes should be printed in advance in the United States and England, for issue by the Allied-controlled Reichsbank, in sufficient volume to meet the requirements of the first month or so, including the initial exchange and subsequently permitted encashments of deposits according to one or other of the schemes presented below. It should be determined now whether the German note presses can be used after occupation, and whether the prospective facilities now and later will cover the need. None of the three schemes would entail a reissue of more than, say, one-fourth the present German note circulation, and upon the basis of schemes B and C below the immediate need for money might be considerably less. If physical facilities are limited, it may be necessary to omit the smallest denominations, say under 20 Marks, from the exchange operation. A table in the Appendix indicates the total magnitudes involved in various denominations. The issue of large denominations, which facilitate evasion of exchange control, taxation, and control of inflation, should be avoided.

After the first conversion deadline, the authorities should announce a short grace period (perhaps two months) during which money not yet converted would be accepted upon presentation of convincing evidence of unavoidable obstacles and of the legitimacy of the claim to convert

(e.g. that the notes have not been smuggled in from abroad, etc.).

In principle, all banks and the postal checking and savings systems would act as agents for the exchange, crediting amounts to be withheld under the various schemes to accounts held with them by the persons submitting currency for exchange. Persons without bank accounts of any description might be required to accept deposit credits with the postal systems for any amount of currency to be withheld from them.

The treatment of time and savings deposits (The German terms are: "Kündigungsgelder", "feste Gelder" and "Spareinlagen")

General freeze -- Inasmuch as these deposits aggregate to something like 116 billion Marks out of a total of 160 billion Marks, it is proposed that they should be immobilized, at least for other than absolutely indispensable current needs. Since time and savings deposits in general represent the "hoards" of individuals and businesses, rather than current operating funds, they appear to be eligible for such immobilizing. We, therefore, recommend an immediate freezing of these accounts with the following provisions for limited availability.

Exception for business needs -- If the depositor can prove that a time or saving deposit originated from the liquidation of his business during the war and that it is indispensable for the resumption or permitted expansion of the business, a transfer can be permitted. Under Scheme A and B for the treatment of demand deposits one-fourth (or whatever the portion is) of the sum in question shall be transferred to "free" demand deposit, while three-fourths shall be indefinitely blocked on special account. Under Scheme C the whole sum will be transferred to an "old" business account subject to the restrictions applicable to these accounts. (See below)

Consumer allowances -- Time and saving deposits not reclassified as business deposits are consumer deposits subject to withdrawal restrictions. Initially, withdrawals from such accounts might be governed by an over-all limit of say 150 or 200 marks per month. An attempt may be made later to distinguish between the needs of consumers according to their family and employment status. Also, in order to prevent simultaneous withdrawals from several different accounts held by the same person (including demand deposits if Schemes B or C for the treatment of such deposits were adopted) a more refined procedure would require that data concerning withdrawals be entered in the person's Arbeitsbuch or such other document as may be determined.

Provisions with Respect to Demand Deposits and Bank Notes

Scheme A:

General character -- This is the simplest scheme administratively, but the crudest in its economic effects, the least equitable, and the least flexible instrument (of the three plans) against inflation. In essence it relies upon an immediate and once-and-for-all freeze of a certain part of demand deposits and currency, the rest to be free, without administrative supervision of use. The fraction of deposits and cash to be frozen would need to be high (possibly $3/4$) to promise effectiveness against inflation.

Specific proposals of Scheme A --

(a) Currency: Three-fourths (say) frozen; one-fourth freely available in cash or as a demand deposit with a bank or the postal checking system; freezing into blocked accounts carried through at the time of currency conversion.

(b) "Old" demand deposits ("old" = antedating the bank holidays): three-fourths frozen; one-fourth freely available.

(c) Reichsbank Giro deposits, postal giro deposits, savings bank giro deposits: Three-fourths frozen, one-fourth freely available.

(d) New deposits (new deposits = made after bank reopening, whether by deposit of cash or by banking transfer): free, [except for the pre-existing ("peace-time") rules ordinarily governing withdrawals from time and savings deposits.]

Appraisal of Scheme -- This scheme involves a minimum of administration because, after the initial freeze, only in the case of savings deposits does it require the banks to exercise any oversight over withdrawals from deposits. There may be a certain psychological advantage in the definiteness of the freeze. The disadvantages are severe. In the first place, once put into effect it allows no subsequent control over the free deposits. If the fraction to be frozen were set too low, inflation could develop from the combination of free cash (which remains of necessity free in any scheme) and the free deposits. There would be no recourse except a repetition of the currency-reissue operation plus additional freezing. In the second place, since the degree of liquidity of different businesses is not the same, a uniform freeze will not remove all excess cash. On the other hand, if the percentage of funds frozen is high (50 or 75 per cent) many business firms will become dependent on new bank loans for their needs of cash (working capital). This has, however, the great advantage that the control of the banks and in the last resort of the Reichsbank over the flow of investment funds by the ordinary means of credit policy is restored.

An alternative policy would be to supply working capital to needy firms not by new loans but by releasing funds from frozen deposits. This procedure, however, appears to be inferior for two reasons: First, once exceptions from the freeze are made, it will be hard to resist the pressure for more and more exceptions. Secondly, if funds are released by unfreezing deposits, the monetary authorities lose control over those amounts; if funds are put into circulation by loans, control is maintained, because the volume of loans can be contracted if necessary.

Scheme B:

General character -- This scheme represents a compromise between Schemes A and C and hence need not be traced out in great detail. As under Scheme A, a part of cash and demand and giro deposits would be definitely frozen. (Possibly the percentage need not be as large as under plan A, say 50 per cent instead of 75 per cent). But unlike Scheme A, the "free" part of demand and giro deposits would not be entirely free but would be subject to certain withdrawal restrictions similar to Scheme C. These restrictions should, however, be regarded as temporary, forestalling immediate psychological reactions which may result in sudden withdrawals. If these restrictions were permanent, Scheme B would not be simpler than Scheme C and would have little to recommend it.

Scheme C:

General character -- This scheme dispenses with the absolute freeze of a portion of cash, demand, and giro deposits, and instead relies upon rules governing withdrawals from deposits.

It involves some discretionary judgment by the individual banks as to the legitimacy of proposed withdrawals in particular cases, and it requires therefore close supervision of the German banking system by the Allied government. Scheme C is certainly more effective against inflation than Scheme A, provided it is well administered and enforced; it is more equitable; and it is more carefully adjusted to the requirements of the particular business.

Special Provisions --

1. Currency: At the time of the currency exchange, all individuals shall receive new currency up to the amount of one month's consumer withdrawals from bank accounts (150 or 200 Marks), the balance being credited to "old" accounts. Businesses (including individual entrepreneurs and professional persons) should accept the entire proceeds of the currency submitted for exchange on "old" accounts from which they may then make withdrawals as outlined below. However, to avoid the necessity of opening new accounts for businesses which have no banking connection and only small cash holdings, immediate exchange into the new currency might be

permitted for such businesses up to the amount of their demonstrated needs for wage payments and till money during the first month following the exchange

2. "Old" demand, (bank giro and Reichsbank giro) deposits, in all banking institutions and deposits of these categories arising from new bank loans or banking transfers: (The German designation is "täglich fallige Gelder").
 - a) In general these deposits represent the operating funds of business; while they should not be frozen and thus paralyze economic life, their outpayment requires precautions against inflationary effects.
 - b) Outpayments for businesses are authorized as follows:
 1. Encashment: for the demonstrated requirements of payroll for ordinary labor (wage bill) and till money requirements (not covered in the currency exchange).
 2. Transfer by cheque or giro: for demonstrated requirements for the following purposes, viz: salaries above a certain minimum, raw materials and other technical or professional costs of production, taxes, debt payment. In the case of materials, the Allied government may wish to require the bank to receive a priority certificate before it honors a cheque.
 - c) If an individual owns a demand (or similar) deposit but cannot demonstrate the necessity of withdrawals for business purposes, his withdrawals shall be subject to the rules governing consumer withdrawals from time and savings deposits, provided however, that the owner of such a demand (or similar) deposit is allowed the option of transferring it to time and savings deposits at any time.
3. New demand (and similar) deposits made by deposit of cash: Free
4. Bank payment of interest on deposits: payment shall be made into the deposit upon which the interest is earned and withdrawal shall be subject to the rules for that deposit.
5. Existing postal giro deposits:

These deposits require separate treatment because, unlike deposits in ordinary banks, there is no contact between depositors and officers.

 - a) These deposits do not aggregate to quite 3 billion Marks, but their velocity has been very high, sufficient indeed to provide a turnover of 176 billion Marks annually,

However, it is not certain whether velocity already approaches close to a maximum set by the mere physical operations of crediting, debiting, clearing through the 20 old giro central offices, etc. We therefore make two alternative recommendations (under c below) based upon future experience with such accounts, one easier to administer and less anti-inflationary, the other more exacting and more effective.

- b) Encashments to be governed by the same rules as obtain for demand deposits, deposits made in cash being free.
- c) Transfers within the postal giro system
 - 1. Less severe alternative: free, i.e. no control. In this case restrictions would have to be placed upon transfers to the postal giro system from deposits with other (more closely controlled) institutions.
 - 2. More severe alternative: same requirements as for transfers of demand deposits, i.e. business purpose to be demonstrated.

Measures concerning private debts -- Not enough is known about the volume of outstanding private debts of different types to make detailed recommendations. It is probable, however, that as in the United States the high degree of liquidity of individuals and non-financial businesses has resulted in a shrinkage of the outstanding debt of all descriptions such as mortgages, corporate bonds, bank debts of industry, etc. There is certainly only a negligible volume of consumer debts outstanding.

It has been recommended already that a moratorium should be declared during the bank holiday. It may be necessary to proclaim a somewhat longer moratorium, at least for certain types of debt during which the situation can be reviewed and further measures decided upon. It should, however, be clearly realized that debt payments on interest and capital by individuals and non-financial businesses to banks and other financial institutions (such as insurance institutions) is an anti-inflationary factor which ought to be encouraged. The most important type of such debt is undoubtedly mortgages on real estate. There will be a big problem in Germany with respect to mortgages on bombed houses. But the present government is already faced with this problem and has undoubtedly taken measures to solve it. This situation will have to be taken as point of departure.

Prohibition of importation and exportation of German currency -- The importation and exportation of German currency should be forbidden from the outset. This is necessary in order to prevent the flight of capital particularly by guilty persons and to prevent any Germans from attempting to escape the exchange of German currency and to take advantage of the (presumably more advantageous) terms of exchange in portions of the present Reich taken over by foreign countries.

German currency outside Germany and in ceded provinces -- Any currency outside of Germany should be added to the general foreign claims to be settled by reparations or otherwise. German currency circulating in those portions of the present Reich which are transferred to other countries through boundary changes should be changed into the new local currency and will represent a claim on the Reich by the foreign governments which have taken over the territory.

How to deal with current inflation -- A distinction was made above between pent-up inflation and current inflation. The Schemes which we have just discussed are, in the main, designed to remove the danger of the pent-up inflation. The danger of a current inflation is, however, just as pressing if not greater. The importance of direct controls has already been emphasized. It goes without saying that a control of wages will be a factor of strategic importance; but it falls outside the area of the present memorandum. To the extent that current inflation results from a current cash deficit of the Government, we deal with it under questions three and four below. As far as the area covered by the present question is concerned, what needs to be stressed is the necessity of strict credit control.

Control of new credits -- Even if the Government budget were balanced by non-inflationary methods, inflation could result from credit inflation on private account. Because of the partial freezing of deposits and the large holdings of Government securities by the financial institutions (for details see question two below and Appendix B), business will depend on the banks and the banks in turn will depend on the Reichsbank for liquid funds. This is especially true if Scheme A or B was adopted. But also under Scheme C, the question of new loans to trade and industry will soon arise.

Not much need be said about the rules of credit control beyond stressing its importance; for well-established principles of monetary and banking policy will have to be applied. Policies with respect to new loans will have to be integrated with the general policy concerning the conversion of German industry from war to peace production. The degree of strictness of credit control, the choice of methods and the institutional setting (authority delegated to the commercial banks, closeness of supervision by the Reichsbank under Allied control) will largely depend upon the extent to which direct controls can be maintained and on their effectiveness. These are factors which cannot yet be foreseen.

This much may be said, however. If it is the policy of the Allies to rid the German economy of totalitarian control by the Government an effort should be made to replace direct control of investment, prices, etc. gradually by the traditional methods of control through monetary and credit policies.

Second Question: The Public Debt

Objectives -- What the A.M.G. should do concerning the German public debt should be entirely subordinated to the short-run objectives formulated above under Question One. A repudiation or a formal recognition of the Hitler debt should be avoided. Whether a defeated Germany will be able to carry an internal debt, the annual service of which requires at this time already 8 billion, is doubtful. It depends on many factors which cannot be foreseen now nor at the time of surrender. But it is a question which should be left for the future German Government to decide.

Facts about the Public Debt -- More detailed statistical data will be found in the Appendix. The basic facts are these: At the moment of occupation (if it comes this year) the Reich debt will probably amount to at least RM 350 billion of which about RM 150 billion will be long-term and about RM 200 billion short-term. The problem of the long-term debt is mainly one of maintaining interest payments. There are no large issues maturing in the next few years and annual amortization payments are not large. Nearly all of the short-term debt, however, will mature during the first six months of occupation.

The short-term debt falls into three nearly equal parts. One-third is held by the Reichsbank and its subsidiaries; one-third is held by institutions which hold balances on behalf of foreigners or by foreign banks; one-third by German credit institutions. (See Appendix, p.)

Of the long-term debt over 8 per cent is held by public monetary and credit institutions; almost 60 per cent by commercial banks, savings banks, credit cooperatives, etc.; 17 per cent by insurance institutions; and only a small fraction, 15 per cent at most, by the public.

What to do with the Reich debt -- The part held by the Reichsbank and other public institutions does not present any problem because these institutions are agencies of the Reich government. It may be presumed that the part of the short-term debt which is owned by or held on behalf of foreigners will be frozen by the occupying authorities and dealt with together with reparations and other foreign claims. The really pressing problem arises in connection with the holdings of the Reich debt by German credit institutions -- one-third of the short-term and the bulk of the long-term debt. The debt held by the public (individual and non-financial businesses) is comparatively small and should not cause much trouble.

The following solution is believed to be adequate from the point of view of the Military Government: The A.M.G. shall appoint a trustee of the Reich Debt associated with the Reichsbank who would announce that during the interim period the amortization of the long-term debt would be suspended and maturities would be automatically renewed at the original conditions. Interest would be paid by the Reichsbank on behalf of the Reich, but to blocked accounts and not in cash. Maturing short-term securities, both of the discount and interest-bearing type, would be converted into a uniform Reich treasury bill bearing interest at around two to three per cent. The institutional holders of such bills would be allowed to discount them with the Reichsbank against credit on a blocked non-interest-bearing account and they would be free to repurchase such bills from the Reichsbank by debit to these accounts.

The crucial question is to formulate the rules which the Reichsbank should observe in releasing funds from these blocked accounts. Such releases must be made, since otherwise the banks and other financial institutions could not meet their obligations. It would seem to be unnecessary and perhaps impossible to set up very specific rules. It is a question which should be left to the supervisors of the Reichsbank to decide. What should be said by way of a general rule is this: The Reichsbank will set free such balances on giro-account to the extent to which the banks need funds to meet the legitimate cash requirements of their depositors within the limits of the withdrawal restrictions formulated earlier. Whether funds should be released to provide for new loans to trade and industry will be a question of the general credit policy of the Reichsbank which was discussed above in connection with question one.

Third Question: Public Revenue and Taxation

Objective -- Even if accumulated liquid funds are wholly or partly immobilized and the danger of inflation from this source ("pent-up inflation") is removed or substantially reduced, the danger of a "current" inflation resulting from an excess of public expenditure over taxes and non-inflationary borrowing still exist. Every effort should be made to reduce public deficits. Strict control over public finances, central government, State and local, should be instituted on the revenue and expenditure side.

Maintenance of existing taxes -- On the revenue side it is recommended that A.M.G. maintains all existing taxes, with the exception of discriminatory levies on racial and religious minorities which should be immediately abolished. (From the financial point of view the removal of the discriminatory levies is an unimportant matter.) All fees, contributions (except those for the Nazi party) including social insurance contributions (unemployment, old age, sickness insurance) should be collected. The same holds for postal, telegraph, telephone fees, railroad fares, etc.

New taxes -- As after the last war, there will undoubtedly be a sharp decline in public revenue. Therefore it will probably be necessary to raise taxes in order to keep inflation in check. If this becomes necessary a rise of the turnover tax (which is now 2 per cent) is recommended and possibly an extension of its base to all kinds of commodity and service transactions. If prices rise, postal, telegraph, telephone and railroad freight and passenger rates should be promptly raised. Similarly excise taxes and import duties (if they are not on an ad valorem basis) should be raised in order to keep pace with rising prices.

It should be emphasized that arguments used in the United States against sales taxes (which correspond to the German turnover tax) are not applicable to a defeated country in the throes of an inflation. Income taxes in Germany are high anyway and a capital levy, which one might think of as an alternative, is much too slow and cumbersome as an anti-inflation measure; at any rate it is not the kind of tax one would recommend to the Military Government.

It goes without saying that public borrowing must be strictly controlled. If the Reichsbank, its subsidiaries and through it the whole German banking system is under strict control, there should be no technical difficulties about that.

Fourth Question: Expenditure and Budget Control

Introduction -- No specific recommendations can be made on this subject, because very little is known about German Government expenditure. The last detailed figures were published in 1935.

General Principle --

It will be probably easier to control expenditures through controlling revenues. But an effort should be made to control at least some types of public expenditure directly. Such control should extend not only

to the Reich Government but also to State Governments (or what is left of them), municipalities, Government enterprises such as railroads, postal, telegraph, telephone administration, Government banks, Government-owned or controlled industries, etc.

Types of expenditures specially watched

Special attention should be paid to the following types of expenditures:

Expenditures for Military and for Nazi Party purposes. These should, of course, be stopped altogether. Police expenditures are closely akin to expenditures for Nazi Party purposes. But the police problem will have to be tackled directly, rather than through financial controls.

Expenditures for War Veterans, demobilized soldiers and officers.

Unemployment relief.

Reconstruction of public buildings, museums, administrative buildings, parks, etc.

Expenditures for these and similar purposes could be easily increased tremendously without going beyond the standards which we or the British would apply at home. We must be clear, however, and it cannot be emphasized too strongly that in defeated and occupied Germany much stricter standards will have to be applied. Otherwise inflation will ensue and nothing will be left for reparations.

A question which is likely to be of great importance is the treatment of Reich obligations to industries for unfinished or unpaid war contracts. Little is known about the German methods of paying for war material. Supposing, however, that payments to German war industries are outstanding, it would seem to be rather anomalous, if the A.M.G. took any steps to effect such payments. It would seem to be natural to cancel all such claims. If this procedure creates difficulties for industrial firms which can be permitted to continue production or to be converted to peacetime production, other means of financing them will have to be found, for example through bank credit.

APPENDIX A

Currency Circulation during the War

Circulation of notes and coin in Germany has more than tripled since the beginning of the war, as the following table shows:

Table I

Currency Circulation, 1938-43
(Billions of Reichsmarks)

	Increase in Year	Circulation, End of Year	Index
1938		10.4	100
1939	4.1	14.5	139
1940	2.3	16.8	162
1941	5.5	22.3	214
1942	5.0	27.3	263
1943	9.2	36.5	351

Of the total currency in circulation at the end of 1942, notes comprised 93.8 per cent and coin 6.2 per cent. The composition of the note circulation at the end of 1942 is shown in Table II. It will be seen that the denomination accounting for the largest sum in reichsmarks is the 50-mark note, while the denomination which embraces the largest number of notes is the 20-mark note. Notes of 20 marks and less account for two-fifths of the value of the total note circulation and for four-fifths of the total number of notes outstanding.

Bank and Postal Deposits since 1938

As Table III shows, bank deposits in Germany have risen since 1938 by almost exactly the same proportion as has currency in circulation.

Table II

COMPOSITION OF NOTE CIRCULATION IN GERMANY, END OF 1942

Denomination	Millions of Reichsmarks				Millions of Notes			
	Amount Outstanding	% of Total	Amount Outstanding (Cumulative)	% of Total (Cumulative)	Number of Notes	% of Total	Number of Notes (Cumulative)	% of Total (Cumulative)
1 RM	290	1.1%	290	1.1%	290.0	21.0%	290.0	21.0%
2 RM ^a	227	.9	517	2.0	113.5	8.2	403.5	29.2
5 RM ^a	747	2.9	1,264	4.9	149.4	10.8	552.9	40.0
10 RM	2,393	9.3	3,657	14.2	239.3	17.3	792.2	57.3
20 RM	6,845	26.7	10,502	40.9	342.3	24.9	1,134.5	82.2
50 RM	9,763	38.1	20,265	79.0	195.3	14.1	1,329.8	96.3
100 RM	5,180	20.2	25,445	99.2	51.8	3.7	1,381.6	100.0
1,000 RM	194	.8	25,639	100.0	.2	.0	1,381.8	100.0
Total notes	25,639	100.0%			1,381.8	100.0%		
Total coin	1,704							
Total currency	27,343							

^a Rentenbank notes. All other notes are issues by the Reichsbank.

Table III

Deposits, All Banks, 1938-43
(Billions of Reichsmarks)

	A		B	C	D	E
End of	Total Deposits (B+C)	Index	Savings Deposits	Other Deposits (D+E)	Time Deposits ^a	Demand Deposits ^a
1938	42	100	24	18		
1941	90	214	53	37		
1942	119	283	73	46	16	30
1943	149	355	96	53	21	31

^a Estimated

Deposits of several large German banks are shown in the table on the following page.

In addition to deposits with banks are the demand deposits with the Postal Giro System. As can be seen in Table IV, these are small relative to total bank deposits.

Table IV

Postal Giro System
(Billions of Reichsmarks)

End of	Deposits	Index	Number of Accounts (Millions)
1938	1.3	100	1.3
1940	1.8	141	1.3
1941	2.4	182	1.5
1942	2.8	214	1.6

Table V

Deposits at Individual Large Banks - End of 1942

Deposits	Deutsche Bank		Dresdner Bank		Commerzbank		Three Berlin branch banks		Credit-Anstalt Bankverein		Bank der Deutschen Arbeit	
	Mill.RM	%	Mill.RM	%	Mill.RM	%	Mill.RM	%	Mill.RM	%	Mill.RM	%
Credit institutions	347	6.2	368	9.2	163	6.4	878	7.2	120	14.9	85	2.6
Others	5,285	93.8	3,641	90.8	2,372	93.6	11,298	92.8	686	85.1	3,240	97.4
Total	5,632	100.0	4,009	100.0	2,535	100.0	12,176	100.0	806	100.0	3,325	100.0
Demand deposits	3,820	67.8	2,592	64.7	1,524	60.1	7,936	65.2	577	71.6	740	22.3
Time deposits and fixed money	1,812	32.2	1,417	35.3	1,011	39.9	4,240	34.8	229	28.4	2,585	77.7
Total	5,632	100.0	4,009	100.0	2,535	100.0	12,176	100.0	806	100.0	3,325	100.0
Time deposits and fixed money due:												
within 7 days	120	6.6	124	6.8	43	4.3	287	6.8	10	4.4	22	.9
up to 3 months	1,136	62.7	846	59.7	510	50.4	2,492	58.8	143	62.4	525	20.3
up to 12 months	535	29.5	396	27.9	425	42.0	1,356	32.0	76	33.2	1,990	77.0
after 12 months	21	1.2	51	3.5	33	3.3	105	2.5	---	---	48	1.9
Total	1,812	100.0	1,417	100.0	1,011	100.0	4,240	100.0	229	100.0	2,585	100.0

Not included in the above figures are the demand deposits held at the Reichsbank by banks, firms, and the German government. These are shown in the table below:

Table VI

Demand Deposits at Reichsbank
(Billions of Reichsmarks)

End of	Total	Index	Public Deposits	Private Deposits
1938	1.5	100	.1	1.4
1939	2.0	132	.2	1.8
1940	2.6	168	.2	2.4
1941	3.6	239	.3	3.4
1942	5.3	346	.4	4.9
1943	8.2	532	.6	7.5

APPENDIX B

Course of German Public Debt, 1938-44

The rate of increase in the German public debt since the beginning of the war has been notably rapid. Between December 31, 1938, and December 31, 1943, the Reich debt rose from 26.1 to 253.1 billion reichsmarks -- an increase of almost tenfold. The relative increase during this period was much greater than for either the United States or Great Britain, as the following table shows:

Table VII

Rate of Increase in National Debt

	End of 1938	End of 1943
National debt, Germany	100	970
National debt, United States	100	431
National debt, Great Britain	100	246

In absolute terms, however, the picture is less unfavorable to Germany. This is shown in Table VIII, in which the national debt per capita for each of the three countries is expressed in terms of dollars.

Table VIII

Per Capita Debt

End of	United States	Great Britain ^a	Germany ^b	
			1 ^c	2 ^d
1938	\$303	\$612	\$164	\$118
1939	320	661	262	190
1940	342	838	460	334
1941	437	1,062	749	543
1942	810	1,281	1,085	786
1943	1,253	1,506	1,441	1,045

^a At present exchange rate (£1 = \$4.035).

^b Per capita figures for Germany are computed on the basis of the pre-Anschluss population.

^c At official pre-war parity (RM1 = \$.40).

^d At estimated purchasing-power parity (RM1 = \$.29).

The above figures provide only a very rough basis for international comparison, because of the difficulty, under present conditions, of selecting satisfactory rates for converting into dollar terms figures expressed in pounds or in marks. The pre-war official dollar-mark parity was a virtually

meaningless figure, and is wholly so now. On the basis of purchasing-power-parity calculations, the appropriate mark rate would appear at present to be more like \$.29 than \$.40. At the official rate of \$.40 per mark, the German per capita debt at the end of 1943 was greater than that of the United States but less than that of Great Britain. At the purchasing-power-parity rate, the per capita debt for Germany was the lowest of the three.

A better view of the burden of the public debt can be obtained by expressing the debt as a percentage of national income. This procedure makes possible significant international comparisons without the necessity of converting figures into a common monetary unit, but the ratios thus obtained must be interpreted with caution, since available national-income estimates for war-time Germany leave much to be desired, and since national income figures in time of war do not have the same significance as in time of peace. These considerations should be borne in mind in examining Table IX.

Table IX

National Debt as a Percentage of National Income

	United States	Great Britain	Germany
1938	61.4%	160.4%	32.7%
1939	59.2		54.7
1940	57.8	172.4	93.0
1941	60.6	188.8	136.0
1942	90.3	204.2	171.4

According to the above figures, the debt-income ratio for Germany at the end of 1938 was much more favorable than for either of the other two countries, while at the end of 1942, Germany occupied an intermediate position between the United States and Great Britain. The latter country was consistently in the least favorable position.

The growth and changing composition of the German public debt since 1938 are shown in Table X:

Table X

German Public Debt, 1938-43

Billions of Reichsmarks

End of	Total Debt	Total Long Term	Total Short Term	% in Long Term	% in Short Term
1938	26.1	21.0	5.1	80.4	19.6
1939	44.6	25.7	18.9	57.6	42.4
1940	78.3	41.8	36.5	53.4	46.6
1941	127.3	63.0	64.3	49.5	50.5
1942	184.4	86.4	98.0	46.9	53.1
1943	253.1	110.8	142.3	43.8	56.2

It will be seen that the fraction of the total debt in short-term obligations has steadily increased since the beginning of the war, rising

from less than one-fifth of the total at the end of 1938 to well over half the total at the end of 1943.

Ownership of German Public Debt

As Table XI shows, much the greater part of the German public debt is held by institutions.

Table XI

Ownership of German Debt, End of 1943
Billions of Reichsmarks

	Total Debt	%	Long Term	%	Short Term	%
"External" institutions						
Verrechnungskasse	16.6	6.5%			16.6	11.7%
Reichskreditkasse	8.6	3.4			8.6	6.0
Konversionskasse	.9	.4			.9	.6
Central banks of						
Bohemia-Moravia,						
Netherlands	5.1	2.0			5.1	3.6
Total	31.2	12.3			31.2	21.9
Monetary institutions						
Reichsbank	42.0	16.5			42.0	29.6
Rentenbank	2.0	.8	2.0	1.8%		
Golddiskontbank	4.2	1.7	1.1	1.0	3.1	2.2
Postal checking, savings	8.3	3.3	6.1	5.5	2.2	1.5
Total	56.5	22.3	9.2	8.3	47.3	33.3
Other credit institutions						
Commercial banks	23.9	9.4	4.0	3.6	19.9	14.0
Credit cooperatives	17.0	6.7	10.9	9.8	6.1	4.3
Savings banks	68.5	27.1	49.7	44.9	18.8	13.2
Mortgage and other special institutions	2.7	1.1	1.5	1.4	1.2	.8
Total	112.1	44.3	66.1	59.7	46.0	32.3
Insurance institutions						
Insurance companies	7.7	3.0	7.7	6.9		
Social-insurance funds	11.2	4.5	11.2	10.1		
Total	18.9	7.5	18.9	17.0		
Total debt held by institutions	218.7	86.4	94.2	85.0	124.5	87.5
Residual, including debt held by public	34.4	13.6	16.6	15.0	17.8	12.5
Total debt	253.1	100.0%	110.8	100.0%	142.3	100.0%

More than a fourth (27.1 per cent) of the German debt is held by the savings banks. The savings banks hold somewhat less than half (44.9 per cent) of the long-term debt and about an eighth (13.2 per cent) of the short-term debt.

The largest single creditor of the Reich is the Reichsbank, which holds 16.5 per cent of the German debt. The percentage is considerably greater if the debt held by four Reichsbank subsidiaries is added. Thus the Verrechnungskasse, which handles clearing arrangements with other countries, holds 6.5 per cent of the debt, and the Reichskreditkasse, a war-time agency concerned with financing German military operations in the field, holds 3.4 per cent. A third subsidiary, the Golddiskontbank, holds 1.7 per cent of the Reich debt, and another .4 per cent is held by the Konversionskasse, which was established in 1933 to administer German foreign debts. Thus well over a fourth (28.5 per cent) of the German debt is owned by the Reichsbank and its subsidiaries. All of this is short-term.

Other important creditors of the Reich are the commercial banks, the credit cooperatives, and the insurance companies. The commercial banks hold 9.4 per cent of the total debt. They rank next to the Reichsbank in their holdings of the short-term debt, accounting for 14.0 per cent of the total. The credit cooperatives hold 6.7 per cent of the total debt, and the insurance companies hold 3.0 per cent. Most of the former, and all of the latter is long-term.

Comparison of Public with Private Debt

Because of the great increase in German public debt, the ratio of private to public debt has changed radically in recent years. This is shown in Table XII.

Table XII

German Private and Public Debt (Billions of Reichsmarks)

	1932	1944
Private debt	64 (69%)	60 (17%)
Public debt	29 (31%)	290 (83%)
	<u>93</u>	<u>350</u>

Appendix C

Policy Recommendations on Treatment of German Insurance Claims

(Prepared in consultation with F. H. Klopstock, Foreign
Research Division, Federal Reserve Bank, New York)

I. Life Insurance

In order to prevent wholesale conversion of life insurance policies into cash, it is recommended that the contractual right of the policyholder to surrender his policy be temporarily suspended. In case the notice of surrender has been received prior to the suspension, but payment of the cash value of the policy has not yet been made, the notice of surrender should be declared void. Exceptions to the prohibition of policy surrenders should be granted only in hardship cases.

It is recommended that the contractual right of the policyholder to call for a policy loan should be suspended.

If the policyholder can prove his inability to remit the premium required under the policy contract, insurance companies should automatically charge the amount of the premium due against the cash value of the policy as a loan and continue the policy in force, provided, of course, that the unencumbered cash value is sufficient. If the policy has not been in force long enough to have a cash value attached to it and would thus ordinarily lapse in case of default of the policyholder on his premium payment, a grace period of several months should be allowed over and above the period provided by the policy contract during which time the policy would remain in force in spite of the fact that a premium has fallen due and has not been paid.

It is recommended that all payments to beneficiaries of industrial life insurance policies should be permitted without any restrictions whatsoever. Claims arising from other life insurance policies, payable on the death of the insured or the maturity of the endowment, should be transferred to blocked accounts of the beneficiary to be held with the insurance company if the company so chooses. In the latter case, the accounts should bear the same interest as savings deposits and be subject to the same withdrawal restrictions as savings deposits under the schemes for blocking proposed above. However, claims arising from policies payable upon the death of the insured should be satisfied up to an amount of RM 1,000 without restrictions in order to provide for funeral and other expenses in connection with the death of the insured.

II. Insurance other than Life Insurance

Insurance companies should be permitted to pay accident, health, property, and fire claims of individuals in cash or by credit to free accounts up to an amount of RM 500. Any further payments to individuals,

or any payments to corporations, should be permitted only to "old" bank accounts subject to the usual withdrawal restrictions. In order to protect the liquid position of insurance companies, however, they should not be required to make payments to blocked accounts at any faster rate than withdrawals from those accounts are to be permitted.

Basis for Recommendations

I. Life Insurance

Prohibition of Surrenders. Life insurance claims may arise through action of the policyholder, such as surrender of the policy against cash payment or through involuntary occurrences, such as the death of the policyholder or maturity of an endowment policy. It seems advisable to prevent the appearance of claims arising out of willful terminations.

Policyholders may withdraw cash by two principal methods: they may either surrender their policies and take the cash surrender value, or they may borrow on their policies and thus withdraw some of the reserve while keeping the policy in force. In case of surrender of policies, insurance companies must refund to the policyholder a portion of the reserve accumulated against the policy. Wholesale surrenders are undesirable in view of the fact that they would deprive companies of their liquid reserves at a time when they would not be able to find a market for their investments, which chiefly consist of government bonds. Another objection against the surrender of policies is that it would furnish policyholders with large amounts of currency accumulated during the life of the insurance contract.

Prohibition of Policy Loans. Policy loans are in reality advances against policy claims and, like the surrender of policies, a means of drawing down a part of the reserve accumulated against the policy. Policyholders have the right to call for policy loans at any time, and they may repay the loans in part or in whole at any time. Policy loans, unless forbidden, would present policyholders with an opportunity to circumvent the prohibition of policy surrenders.

Prevention of Lapse of Policy Contracts. In normal times, lapse of insurance policies results from the unwillingness or inability of the policyholders to maintain premium payments on their policies. During the period of large-scale economic disturbances, which are likely to follow the invasion of Germany, many policyholders will by force of circumstances have to discontinue their policies. Since in many cases the policyholders will be able to resume payments with the passing of the emergency, it would be unfair to them to permit loss of their savings due to temporary inability to meet premium payments.

Claims of Beneficiaries. A more liberal policy should be pursued as regards terminations which do not result from any action on the part of the policyholder and represent the accomplishment of the purposes for which the policy was originally purchased. The general principle in the

treatment of these claims should be to permit contract fulfillment up to an amount large enough to satisfy the immediate needs of the beneficiary. In case of industrial policies, the face amounts of which averaged only RM 390 at the end of 1941, restrictions on payments to beneficiaries would only cause hardships as the insured amount is ordinarily required for covering the burial and other expenses arising in connection with the death of the insured. For the same reason, beneficiaries of policies payable upon the death of the policyholder should be permitted to receive up to RM 1,000 in cash. The excess over RM 1,000 should be treated as a special form of saving. In order to protect the liquidity of the insurance companies it seems advisable to allow these deposits to be left with the insurance companies rather than to require their transfer to banks or savings banks. This provision can be changed later, if necessary. The resulting savings deposits should be treated according to the general plan outlined above on page 5. But care should be taken to make sure that the depositor does not make simultaneous withdrawals from deposits held with different institutions.

II. Insurance other than Life Insurance

Interference with the contractual relations between the insurers and the insured should be kept to a minimum so that the insurance industry will be able to continue the performance of its vital functions without impairment. If they are in a position to do so, insurance companies should be permitted to pay all claims, including large claims, into blocked ("old") bank accounts, since it makes no appreciable difference whether funds representing insurance claims are held in the blocked accounts of insurance companies or in those of policyholders. An imposition of restrictions on claim payments would only be followed by cancellation of policies and the stoppage of premium payments. But it is recommended that in order to relieve the pressure upon insurance companies resulting from large claim payments at a time when their claim reserves may be relatively illiquid, they should not be required to make payments to "old" bank accounts except to the extent that withdrawals from these accounts are to be permitted. Insurance companies might be required to pay interest at a low rate (1 to 2 per cent) on such matured but untransferred claims.

Accident, sickness, and fire give rise to extraordinary expenditures on the part of the injured person. It is, therefore, recommended that individuals who have protected themselves against such contingencies by the purchase of an insurance policy be authorized to receive some part of their claims in cash. If the claim payments are made to "old" bank accounts, the above-mentioned contingencies would, in most cases, lead to applications for a license to withdraw cash because of hardship. The suggested procedure would make such applications unnecessary up to an amount of RM 500 and would thus save the administrative agencies a great deal of work.

In this connection, it may be noted that damage to property caused by the war is not considered an insurable risk in Germany. The reimbursement of injured parties is regulated by the war property damage decree (Kriegssachschädenverordnung) of November 30, 1940 and a number of executive orders issued under this decree. Under these regulations, claim payments by the Reich Government to injured persons are limited to comparatively small amounts. It may be well to continue these regulations essentially unchanged.