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Investigating the Intellectual Origins of Euroland's Macroeconomic Policy Regime: Central Banking Institutions and Traditions in West Germany After the War

by

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"The reasons for the success of German monetary policy in defending price stability are in part historical. The experience gained twice with hyperinflation in the first half of this century has helped to develop a special sensitivity to inflation and has caused the wider public to believe in the critical importance of monetary stability in Germany. For this reason, the strong position of the Bundesbank is widely accepted by the general public - questioning its independence even seems to be a national taboo. This social consensus has yielded strong support for the policy of the Bundesbank. … No government has ever seriously considered modifying the Bundesbank Act as a means to deal with cases of conflict, although it could have done so with a simple majority of the Parliament. Historical experience in Germany testifies to the success of the concept of an independent central bank. Inflation rates have remained far below the average rates of most other industrial countries. Stable prices have contributed to a fairly stable social climate, which is felt to have favored growth of the German economy; this has strengthened its role in the world economy. The German currency, the Deutsche Mark, has become a major reserve currency in the world and the "anchor currency" in the European Monetary System, and it enjoys a high standing. ... In the light of the success of the Bundesbank, it is only natural that the German public will expect that any successor, which could take its place at the European level, should be at least as well equipped as the Bundesbank to defend price stability" (Hans Tietmeyer 1991: 182-3; Bundesbank president 1993-9).

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1. INTRODUCTION

This paper investigates the (re-)establishment of central banking in West Germany after 1945 and the history of the Bundesbank Act of 1957. The main focus is on the early emphasis on the "independence" of the central bank, which, together with a so-called "stability-orientation" in monetary policy, proved a lasting German peculiarity. The paper inquires whether contemporary German economic thought may have provided a theoretical case for this tradition and scrutinizes the political calculus that motivated some key actors in the play.

Contrary to a widespread presumption, Ordoliberalism—the dominant contemporary force within the German economics profession widely held to have shaped the new economic order of West Germany called "Soziale Marktwirtschaft" (social market economy)—is found to have had no such impact on the country's emerging monetary order at all. In fact, important contradictions between the postulate of central bank independence [CBI] and some key ideas underlying Ordoliberalism will be identified. Nor can an alternative (more Keynesian) policy regime and its model of CBI that was developed in the mid 1950s by the Economic Advisory Council of Ludwig Erhard, West Germany's famous first economics minister, claim any credit for the eventual legal status of the central bank that became enshrined in the Bundesbank Act of 1957; that policy regime subsequently remained untouched despite the (Keynesian) Stability and Growth Act [SGA] of 1967.

Section 2 revisits the Allies' role in re-erecting a central banking system in West Germany in 1946-8. Section 3 reviews the conflicting views of central bankers and the Adenauer government on the issue of their relationship and cooperation in economic policy, while section 4 identifies the "Übergangsgesetz" (interim law) of 1951 as the starting point of the German CBI tradition. Section 5 then investigates whether the postulate of CBI may have any theoretical foundation in Ordoliberalism, whereas section 6 reviews the Keynesian model of CBI designed by Erhard's Economic Advisory Council in the mid 1950s. Economics minister Ludwig Erhard's role as ordoliberal and CBI proponent is the subject of section 7, before the Keynesian economics minister Karl Schiller's part in Germany's CBI tradition and in relation to the SGA of 1967 will be discussed in section 8. Section 9 concludes.

2. CENTRAL BANK INDEPENDENCE DUE TO ALLIED OPPRESSION?

The Bank deutscher Länder [BdL], established on March 1, 1948, and forerunner of the Deutsche Bundesbank erected in 1957, is generally seen as a compromise between conflicting British and American ideas in this area.[1] Contrary to the Potsdam Agreement of August 1945, which required the Allies to treat the four occupation zones as a single economic unit, developments between the financial sectors of the three western zones quickly became rather diverse.[2] Guided by the Bank of England's centralized organizational structure, British occupation policy focused on conserving what was left of the old Reichsbank including its centralized structures. As early as November 1945, the Reichsbankleitstelle, Hauptverwaltung der Reichsbank in Hamburg took up functions for the whole of the British zone. Plans originating from within the Reichsbank for re-centralizing German central banking and finance in Hamburg (after the loss of the Berlin Headquarter) were welcomed by the British. Traditionally good relations between the Bank of England and the Reichsbank had survived the war. There was also the more pragmatic interest in coping with mounting occupational costs and not destroying what might still be intact or easily repairable.

American thinking ran along different lines though. To secure a permanent weakening of defeated totalitarian Germany, decentralization represented the United States' key policy maxim. The old centralized Reichsbank was considered part of the Nazi regime. In view of the decentralized structure of the Federal Reserve Bank System, too, it must have seemed natural to re-draw Germany's central banking landscape along home-model lines. While a corresponding plan (due to Joseph M. Dodge) was rejected by the Allied Control Council (the quadripartite body governing Germany) in Berlin to be put in place in all four zones, the Americans pushed through their ideas and established Landeszentralbanken ([LZBs] central banks at the Länder level) in their zone at the start of 1947 (Häuser 1998).

Whereas the French quickly followed suit and established LZBs in their zone in February 1947 too, the British only did so in March 1948, reluctantly and after attaining the American concession to establish the BdL. Initially erected as central bank for the newly

[1] See Adler 1949, Loehr 1952, Wandel 1980, Horstmann 1989, 1990, 1991, Dickhaus 1997, Buchheim 1998, Holtfrerich and Iwami 1999, and Distel 2003, for instance.

[2] Abrupt change occurred early on in the Soviet occupation zone, but will be excluded from the analysis here.

formed "Bizone" (the jointly governed U.S. and British zones), it was joined by the French LZBs just before the currency reform of 20 June 1948 (retroactively to 25 March 1948).

Earlier American planning had foreseen a central control and coordinating board for the LZBs, particularly Dodge's plan for a Länder-Union-Bank of April 1946. The British successfully pressed for a proper bank rather than a board, and one that was to also include a board of managers ([BM]; Direktorium) at the system's centre in addition to its central bank council ([CBC]; Zentralbankrat) representing the heads of the LZBs. As it turned out, with Wilhelm Vocke as president of the BM, the British idea of a powerful centre for the decentralized central banking system soon became reality. Vocke, who had a Reichsbank background and Bank of England backing too, not only became the dominant figure at the BdL, but also a key force behind the newly founded central bank's push for independence. In his memoirs, Vocke (1973) described the Bank of England's long-time governor Montagu Norman with exuberant adoration, praising him as the Treasury's antagonist and decrying the Old Lady's fateful subordination to HM Treasury.

As the Allies' imposed BdL law of 1948 explicitly stated that the bank would not be subject to instructions from German political authorities, it might at first appear as if foreign oppression was wholly responsible for starting the tradition of CBI in Germany (cf. Buchheim 1998, 2001). While seemingly a sharp break with former Reichsbank traditions of ultimate political control exercised by the Reichskanzler, since the Deutsche Reich respected the gold standard—the Reich had gone on to gold in 1871 with the Reichsbank being established five years later to safeguard the gold currency—in truth neither the Chancellor nor the bank was properly in charge of an independent monetary policy though (Holtfrerich 1988, James 1998).[3] A real contrast was that while in the old days any decision to go off

[3] It is of some interest in this context that although the Reichsbank became legally independent from German (albeit not from Allied) political control with the Autonomy law of 26 May 1922 (confirmed in the Banking Law of 30 August 1924), this did not prevent the bank from committing catastrophic blunders: first the hyperinflation in 1923, then the banking crises and deflation in the early 1930s, followed by the Nazi era. In this light, it would seem fair to say that Germany's previous experience with CBI was exceptionally poor (Giersch and Lehment 1981). Apart from elegantly rewriting German history—turning the rather real consequences of Hitler's "Totaler Krieg" into an apparently purely monetary phenomenon— the bank's symmetry of failure conspicuously contradicts what is habitually described by modern Bundesbankers as the historical background to their post-WWII success. (Hans Tietmeyer sums it up nicely in the quotation at the start.) Johnson (1998: 199) refers to the Bundesbank's "orchestrated efforts to reinsert memories of the hyperinflation of the 1920s into Germany's postwar political mythology," but he may well underestimate their lasting impact on public opinion when judging that "the myth of the 'lessons of hyperinflation' has always been rivaled by another memory that found a broad reception in the late 1960s—the role of the independent Reichsbank in triggering and aggravating the Great Depression. While the hyperinflation of 1923 certainly contributed to Weimar Germany's social ferment, it cannot be overlooked, as the Bundesbank is now inclined to do, that the active

gold, for instance, rested with the Reich's political authorities, no central German political authority that could have given instructions to the bank existed at the time when the BdL was established anyway.

Without any central German government or parliament in place at the time when the BdL took on its role as the first tri-zone institution in the context of the currency reform of 20 June 1948, whatever political influence in monetary matters there was on the German side, it resided with the Länder. While not in a position to give instructions to their LZBs either, the Länder governments' control powers rested mainly in their right to appoint and dismiss the LZBs' top personnel. Given that the LZBs' heads made up the BdL's CBC, the Länder had some political power over the BdL too, albeit exercised in a decentralized fashion; an aspect CBI proponents later on came to stress. This situation was a result of the federal structure of the emerging West Germany, which was a product of the Allied policy of decentralization. Off with a head start, the BdL was put in a rather strong position when Germany's first federal government later entered the play—faced with the vested interest of the Länder too.

In view of both the *Zeitgeist* (cf. Kisch and Elkin 1930, Einzig 1935, Kriz 1948) as well as their respective home situation it nevertheless seems puzzling that the Allies explicitly stated the BdL's independence from German political control in the first place. With the New Deal and war-related rise in the United States' public debt ratio the Federal Reserve System came under close guidance from the Treasury until the 1951 Accord (Sylla 1988). Similarly, close Treasury-Bank of England cooperation had emerged after September 1931, which became no less important with the war-related leap in Britain's public debt ratio. The Old Lady was nationalized and the Treasury granted the right to give directions to the bank in 1946 (Cairncross 1988, Fjorde 1992). The French government exercised rather direct control over the Banque de France since the 1936 law and nationalized the bank in 1945 too (Bovier 1988). In addition, the German Länder authorities pushed hard for more influence over the LZBs and BdL (Adler 1949, Möller 1976, Horstmann 1990, Bundesbank 1998). Why should the Allies have wished to equip Germany with, what is today widely considered a public good, CBI?

The point is that the BdL was *not* independent at all. It was under all-comprehensive Allied control. For Article II of Law no. 60 of the American military government (BdL Law) stated that: "In determining the polices of the Bank, the Board of Directors shall be subject to

complicity of Hjalmar Schacht and the independent Reichsbank in the Great Depression helped bring Hitler to power" (Johnson 1998: 24).

such directions as may be issued by the Allied Bank Commission." In line with what the 1946 Dodge plan had earlier on foreseen for the Länder-Union-Bank, an Allied Bank Commission [ABC] was established together with the BdL (and residing with it under the same roof) in order to exercise Allied, rather than German, control over the bank.[4]

And, at least initially, the ABC took a hands-on approach to supervising the BdL, including top personnel matters, policy determination and implementation as well as financial supervision issues. The BdL was not only highly aware of this, but strongly disliked its dependence. Interestingly, in pushing its own cause and policies, the bank did not shy away from conflicts with the ABC. Perhaps to test how far it could go, especially in the initial phase "the BdL tried often to dissent, pursuing policy contrary to the Allies" (Dickhaus 1997: 301).

Later on supervisor and supervisee came to like their relationship much better and even tried to conserve it as political developments were pointing towards change. Inevitably, a significant change occurred in September 1949 when the Military Governments' powers were passed on to the Allied High Commission [AHC] in the context of the "Besatzungsstatut." While continuing to reside with the BdL, from then on the ABC was merely reporting to the AHC's Finance Committee [FC], which took over responsibility (Lindenlaub 1992). The FC found itself in an uncomfortable position though. On the one hand, the FC seems to have had no inclination to exercise hands-on supervision; probably because it felt that its days were numbered anyway as Germany was soon to take over matters. On the other hand, it nevertheless remained responsible until that was actually going to happen. Thus, the FC actively encouraged the new German government to pursue change in this sphere.

It is of some interest that the AHC did not consider it appropriate to simply withdraw its powers over the BdL, which would have left a corresponding vacuum of political control. Rather, it pressed the German government to establish a substitute arrangement before it thought it could do so. In fact, right from the beginning the Allies seemed conscious about creating nothing more than an interim arrangement. There was no intention to pre-empt a German decision and force CBI upon the country. Deciding that matter was merely

[4] The agreement on establishing the ABC of 16 February 1948 reads: "for the purpose of exercising general supervision over the policies of the Bank Deutscher Länder to the end that the objectives of U.S. Military Government Law No. 60 and British Military Government Ordinance No. 129 establishing the Bank shall be carried out" (Historical Archive, Deutsche Bundesbank [in the following: Buba HA], file 610). Cf. Distel 2003.

postponed. Understandably, though, the Allies felt no inclination to deal with a central bank that was independent of their own control as long as they were still in charge.

This is not to say the Allies had no impact on subsequent developments at all, the fact that the BdL ended up in a position of far-reaching independence within the newly founded West German federal republic in particular. But their contribution was more indirect in nature. Not because of its supposed independence, but as a by-product of the Allied policy of decentralization and federalization of Germany the BdL was put in a rather strong starting position. For when Germany's first federal government entered the play it was facing both the vested interest of the Länder (Könneker 1957, Goodman 1992) as well as a central bank that had enjoyed a head start in matters of reputation building.

3. CONFLICTING VIEWS OF THE ADENAUER GOVERNMENT AND THE BdL

Article 88 of West Germany's *Grundgesetz* (preliminary constitution) of 23 May 1949 ordered the federal government to "establish a central bank and bank of issue as a Federal Bank [Bundesbank]." In August 1949 at the latest, serious internal discussions started at the BdL to prepare for that event. There was some disagreement within the bank on the extent to which the decentralized structure of the system should be conserved and the BdL, as erected by the Allies, simply become the Bundesbank—a solution that was favored by the Länder and a majority of central bankers. Another position preferred a more centralized institutional solution though. On this issue, as on others, tensions were present from early on between Wilhelm Vocke, president of the bank's BM, and Karl Bernard, president of its CBC, as a kind of rivalry between the bank's two governing bodies and leaders had quickly emerged. As far as securing the bank's independence was concerned, however, central bankers seemed united in pursuing their institutional-political interests with utmost determination.

The BdL championed an arrangement which foresaw that the election of its two presidents would require confirmation by the Bundespräsident (Head of State) and that a standing committee, consisting of the Bundeskanzler, the economics and finance ministers, and the bank's two presidents, should be formed. The committee's foreseen role was to regularly discuss all principle matters in economic policy and credit policy "in trusting collaboration."[5] On the one hand, the BdL's favored "minimal solution" shows that the bank

[5] Note of 29 September 1949 of a BdL working group on the Bundesbank question (Buba HA, file 358). In his letter to Adenauer of 31 October 1949 Vocke made a similar proposal (Buba HA, file 2011).

was not under the illusion that it might retain its position of complete independence from federal German political control. On the other hand, the bank was clearly pushing for an extreme form of independence—compared to contemporary arrangements elsewhere and against international currents prevailing at the time.

Unsurprisingly, the federal government had different ideas, although lacking general agreement on both the issue of organizational structure and the exact way in which its relationship with the bank should be structured. Allegedly, Ludwig Erhard, Germany's first economics minister and famous originator of the "economic miracle," was a champion of CBI, an issue to be further investigated in section 7 below. Following Anglo-Saxon traditions, but against German ones, it was finance minister Fritz Schäffer though who was responsible for drafting the new Bundesbank Act. And this was just one among several issues that shaped the rivalry between the two ministers for years to come, with Erhard advocating a centralized re-organization and Schäffer laboring to largely conserve the Allies' decentralized model.

As Schäffer saw it, CBI might well serve its purpose, occasionally, namely as his shield against parliamentary spending demands. But Schäffer's overreaching guiding principle in this matter was that the government's responsibility for a unified economic policy was indivisible and that the central bank must not be in a position to topple the government. He could be sure of Chancellor Adenauer's full support for this conviction.

Interestingly, initially, there was quite some support at the Länder level too for securing the federal government's influence over the bank. For instance, at a conference of finance ministers in Königstein in December 1949 a proposal was drawn up for the control of monetary policy through a ministerial economic policy council of the federal government. While not giving any specific instructions to the central bank, the Council would develop guidelines to be followed by the bank. Designed to combine an elastic monetary policy with sufficient protection of the currency, the bank was foreseen as enjoying a veto right in case of either consumer price increases or rises in unemployment in excess of certain upper thresholds (seen as signalling inflation or deflation risks respectively). Similar thinking still prevailed by mid 1950 in the relevant committees dealing with the issue for the Bundesrat (the upper chamber of parliament representing the Länder). This was partly a reflection of Länder frustration with their own lack of influence over BdL policy in 1948-9, a situation the Länder felt was unacceptable given that they had to bear responsibility for the outcomes. They were also annoyed by BdL attempts to push back further any Länder influence over their respective LZB and the BdL. But these sympathetic feelings were soon to be overshadowed by the emerging rivalry between the Länder and federal governments, sparked off by issues like the distribution of central bank profits, for instance.

The earliest plans at Schäffer's finance ministry were drawn up along old Reichsbank lines, with a Kuratorium (headed by the Bundeskanzler and under the federal government's majority control) determining guidelines for monetary policy to be followed by the bank. But the first expert draft (of 10 February 1950; Buba HA 358) to be submitted to the BdL for discussion explored a new approach, specifying the bank's goal as that of "safeguarding the currency under consideration of economic necessities." Government representatives could attend CBC meetings enjoying veto powers. The Bundespräsident would appoint and might dismiss (for important reasons) the BdL's two presidents. In addition, he would appoint the chairman of a new "Appellationsinstanz," which would rule in cases of conflict (i.e., government veto). This special federal arbitration body would include five delegates from the BdL and federal government each, with its chairman enjoying the casting vote in case of a tie.

Lacking any sympathy with Schäffers' draft, the BdL reciprocated with an own draft. It accepted the formulation of the policy goal, grudgingly (handwritten comments on the draft read: "the primary goal of the bank is to safeguard the currency"), but the bank demanded a hearing prior to any dismissal. Its main criticism was directed at the Appellationsinstanz though, which the bank argued would dismantle its independence and thereby undermine trust in the currency. The bank pointed out correctly that Schäffer's draft would make monetary policy decisions and responsibilities very opaque. As an alternative the BdL proposed a second round of voting by the CBC in case of government veto.

In essence, this earliest batch of proposals reflected conflicting views on the issue of who should have the final word in economic policy determination and what this would require from the BdL in terms of cooperation with the government. On the one hand, the BdL accepted that, in principle, it was the government's right to lay down the relevant goals of economic policy. On the other hand, the BdL held that this right should reach only so far as the bank judged that aligning its monetary policy with the government's economic policy might be possible at any juncture. Essentially, it would thus be at the bank's discretion to declare the limits of acceptable cooperation, opening up the possibility of bank opposition or even outright dominance. Having its discretion overruled by some "referee" (under government control) was unacceptable, from the BdL's viewpoint.

It was equally unacceptable to Schäffer that the bank should be in a position to oppose the government. As the latter bears ultimate responsibility for policy outcomes, in his view, it must also have the final word. Schäffer strongly held that the government must not allow "its economic policy being dictated by the CBC," which was exactly the way Adenauer felt about the matter too.[6] In fact, a new draft from the finance ministry of 5 September 1950 put the Chancellor himself in the position of chairman of the Appellationsinstanz. While the bank's goal was now to "safeguard the currency," in fulfilling its functions the bank would have to consider the government's general economic policy, with the guidelines for currency and credit policy being determined by the bank and the government conjointly.

Clearly, the bank and government's respective positions were incompatible. It is noteworthy that Schäffer's position was much akin to arguments put forward by no other than Milton Friedman (1962), emphasizing democratic control and the unity of responsibility for economic policy. In his fierce critique of CBI, Friedman rejected the concept for both political as well as economic reasons. By contrast, for those who hold that certain aspects of monetary policy require technical expertise and should be free from any direct political interference, the trouble with this earliest confrontation of views is that it is never made all that clear as to which policy aspects those "guidelines" or "instructions" might actually refer in practice. In modern terminology, it is not clear whether the government would determine the goals of policy (and the bank be merely instrument independent but goal dependent), or whether the government might instruct the bank on the instrument setting (i.e. policy stance) too.

From occurrences in 1950 it might appear that what Adenauer really had in mind was that he should have the final word on the rate of interest. Interestingly enough, though, early confrontations in 1950 seem to have provoked calls in favor of the BdL's independence in the media and impacted on public opinion in the same way (cf. Dickhaus 1997: 309-10, fn 87). Of course both Adenauer and Schäffer would claim in public that they were in favor of CBI and did not want the bank to be dependent on their instructions.

4. THE END OF ALLIED CONTROL AND THE "ÜBERGANGSGESETZ" (INTERIM LAW) OF 1951

[6] Adenauer wrote to Schäffer on 26 July 1950: "In summary, we need to find a solution which provides the government with the option to give instructions to the central bank in case the bank refuses to undertake a

In the autumn of 1950, the situation was thus in a deadlock. There was some broad agreement within the government (and the coalition parties that formed it) that the Bundesbank should be neither completely independent nor directly dependent on instructions. But great confusion prevailed as to what form of independence might establish the right balance and secure the desired kind of political control in practice. As explicitly focusing on the bank's policy remit and bank-government cooperation had proved complicated, attention shifted more and more toward the appointment issue. Clearly, attempts to secure government influence on monetary policy via personal relationships rather than policy remit provide a far less transparent route. As another complication, this route set the vested interests of the Länder governments clearly against the federal government's ambitions.

At the start, the heads of the LZBs forming the BdL's CBC were all appointed by the Länder governments, while the CBC itself elected the BdL's two presidents as well as the remaining MB members; with all this taking place under Allied Control. The federal government, non-existent when the LZBs and BdL were established, started out from a zero share of political influence in the appointment process and over monetary policy generally. While the Länder and federal governments had a shared interest in pushing back central bankers' role in the appointment process, the tricky issue was to carve out the new balance of power between themselves. This applied to the issue of whether the federal government should gain any say on the matter of the LZB representatives on the CBC. And it applied to the question whether appointing the MB should be under the federal government's control alone. Finally, there was the issue of balance in representation on the CBC, where LZB representatives by far outnumbered MB members.

Particularly, as one fraction of the federal government led by Ludwig Erhard was seeking a full re-organization of the central banking system towards a more centralized solution, the Länder governments were highly alert that the federal government's gain in control should not decisively reduce their own powers. These concerns were not eased by attempts to completely sidestep the Bundesrat by arguing that the Grundgesetz ordered the federal government to establish a "federal bank" and thus excluded any role for the Länder in this matter anyway (a controversy that ended up before the constitutional court).

While the body politic was thus caught up in power fights among itself, the BdL was pleased with its *de facto* status of far-reaching independence from both German and Allied

measure that is required to support the implementation of government policy" (Bundesarchiv Koblenz [in the following: BA], file 102/5706; my translation).

political control that had emerged after September 1949 and in no hurry to see any change to it. The bank was quite annoyed when the Federal government, without its prior consultation, promptly raised the issue of adapting the BdL's statutes with the AHC in the autumn of 1949. In the end, however, the decisive stimulus to reform the BdL's position actually came from the Allies' side. In the context of the revision of the statute of Germany's occupation of 6 March 1951, the AHC sent a letter to Chancellor Adenauer asking him to bring about the conditions for German control over the BdL that would allow the Allies to give up theirs:

> "The Allied High Commission appreciates that these responsibilities could not, without serious inconvenience, be given up so long as no legislation has been enacted establishing a competent Federal authority to assume them" (letter of 6 March 1951; reprinted in: Bundesbank (1988: 101).

Not the request for change as such, but its timing surprised the government. Discussions between the two sides had been going on for some time, and they had influenced the tactics used by Schäffer and Adenauer in negotiating the Bundesbank Act. At the cabinet meeting of 6 December 1950 Schäffer informed his colleagues that the Bundesbank question was becoming an urgent matter as the ABC was about to be dissolved. But then the issue dragged on, the expected letter from the AHC was delayed, so that on 23 February 1951 Schäffer had just submitted to the cabinet a new draft of the Bundesbank Act —when the AHC letter finally did arrive on 6 March 1951.

Subsequent developments led Hentschel (1988) to conclude that Schäffer saw the Allies' prompting as a welcome opportunity to take both the cabinet and the BdL by surprise. Schäffer informed the cabinet about the AHC's initiative at its meeting on 20 March, arguing that the new situation required either immediate agreement on the Bundesbank Act or the creation of some interim arrangement. The cabinet unanimously decided at that meeting that "a draft of an interim law has to be produced soon, which would, in principle, foresee the federal government to take the place of the ABC. The presidents of the CBC and the MB should be called in to the discussion of this draft" (Cabinet Minutes 1951: 259-60; my translation). Schäffer asked to put this on the agenda for the cabinet meeting on 30 March.

Apparently, the BdL only learned about the cabinet's decision on March 26 or 27. A CBC meeting on March 29 rejected the plan, vigorously asking the government to pursue no more than the repeal of the Allies' control authority. Note that the conflicting positions had thus moved to their extremes. Schäffer's idea to have the government step in in the ABC's place would have provided the government with an all-encompassing grip on the BdL, even if “transitorily” only. Equally radical, on the BdL’s proposal, the bank would have secured a *de jure* status of complete independence; which the BdL argued ironically enough, would bring no practical change to the *status quo* as the ABC had not been using its authority for quite some time. As a compromise, the BdL suggested to add stipulations that would oblige the bank to take the government’s general economic policy into account, while changes to its statutes would require confirmation by the government too.

The BdL’s compromise formula formed the basis for subsequent negotiations between the government and the bank in early April. At the final stage of these negotiations Adenauer intervened in order to strengthen the bank’s obligation to “support in adequate ways” the government’s policy. The draft law submitted to the upper chamber of parliament on 2 May 1951 reads: “The BdL is obliged to take the government’s general economic policy into account and to support it in the context of its tasks” (my translation). Passing the upper chamber of parliament, this formula was also accepted by the relevant “Committee for Money and Credit” of the lower chamber, which expressed reluctance to add too much detail to the interim arrangement for fear that this might prejudice the final law. The committee’s lead member from the Social Democratic Party, Walter Seuffert, expressed concern about the lack of any stipulations in case of conflict, a concern that was shared by the committee’s chairman Hugo Scharnberg from the Christian Democratic Party. In the end, the only details added concerned the government’s participation rights in CBC meetings and its right to defer the CBC’s decision-taking for a maximum of eight days.

As it turned out, the hurriedly negotiated “Übergangsgesetz” (interim law) that came into effect on 10 August 1951 prejudiced the final law—which was going to take another six years of negotiations—in all its essentials. The law of 1951 properly established the German tradition of CBI, featuring a vaguely defined remit for the bank together with its obligation to support the government’s general economic policy; albeit leaving it at the bank’s discretion to determine the point at which it might more or less openly oppose the government.

All avenues along which Schäffer had previously tried in his various drafts to make sure that the government would safely have the upper hand in dealing with the bank had become blocked. In line with Vocke’s vision, the bank had secured a position as the government’s antagonist. Thus, from then on the government was forced even more to focus on whatever leverage it might gain on the appointment of the bank’s leadership. In this area, however, the federal government’s ambitions conflicted with the vested interests of the Länder. In this political game of gaining influence and erecting barriers against others’ influences, there was only one proper winner: central bankers. Of course the BdL was in no hurry to see any final law get passed that might have weakened what it had attained. Particularly, as the interim law offered it a welcome chance, building on its head start in 1948, to further nourish its own public prestige; perhaps even at the government's expense.

5. INFLUENCE OF ORDOLIBERAL IDEAS: IS CBI REALLY COMPATIBLE WITH ORDOLIBERALISM?

According to Abelshauser (1991), Germany embarked on a special path in 1948 as far as its "Ordnungspolitik" was concerned, i.e. policies aimed at organizing a market economy and regulating its order of market competition. While aspiring to overcome traditional liberal views on economic order, the country did not join in the international triumph of Keynesian demand management either. The economic instabilities of the 1920s and the Great Depression were seen as a failure of laissez faire, or lack of government intervention of the right kind, namely, in organizing and regulating its market order. Early practical experiences with Keynesian policies in overcoming the Great Depression in 1932-3, if anything, helped to discredit Keynesianism. The perception was that these "full employment policies"—seemingly inevitably—evolved into the full-blown command economy of the subsequent Nazi era.[7]

For instance, Alfred Müller-Armack (1947), a leading ordoliberal and high-rank official in Ludwig Erhard's economics ministry, called for a synthesis between the market and the state that required the state to relinquish any form of control that is in contradiction to the market economy and employ only those that are "marktkonform" (in agreement with the market order): "A synthesis is only possible with a form of control which, both in its totality and in each individual measure, focuses on sustaining, if not improving the market economy" (Müller-Armack 1947: 90; my translation).

What might this principle imply with respect to monetary policy? In particular, how does CBI fit into the ordoliberal view of a sound economic order? Providing a good starting point, Walter Eucken (1952), figurehead of Ordoliberalism and leader of the "Freiburg School," stated the following principles of government policy. First, policy should focus on

[7] A conspicuously strong disdain for any Keynesian thought is common among ordoliberals. Peacock (1993: 6-7) reports of "a curious incident during a seminar at the University of Freiburg im Breisgau, where Walter Eucken, the famous German liberal, had established his Euckenkreis." He relates the "emotional reactions" to the preface of the German edition of The General Theory and the fact that many ordoliberals suffered Nazi persecution.

dissolving economic power groups or constrain their operation. Second, policy should be limited to moulding the *forms* of the economic order, but not include control of economic *processes*. While the first principle directs policy toward dissolving concentration of economic power within the financial system, the second orders the state to set up a monetary order which does not involve ongoing state intervention in the economic process itself.

As a matter of principle, any government intervention in economic processes within the currency sphere would thus be ruled out. Or, could there be any exceptions to this rule? One relevant idea, due to Alexander Rüstow (1932), is that "liberal interventions" may be acceptable, namely those which do not affect the free determination of price. Another, due to Wilhelm Röpke (1942, 1950), is akin to Müller-Armack's notion of "marktkonform": interventions, on this count, are "liberal" as opposed to dirigiste, if they do not abolish the price mechanism and self-control of markets, but become merely assimilated in it as new data.

These qualifications do not change our verdict at all: interest rate policies, as currently practiced by central banks all over the world, are nothing else but ongoing interventions in market processes. Obviously, the determination of interest rates is not being left to the self-control of markets. No matter whether carried out by independent or dependent central bankers, interest rate policies do not qualify as "Ordnungspolitik." The Economist (1999) quite properly referred to the peculiar role of central bankers in today's world of market enthusiasm and liberalization as that of "central planners." These planners may set interest rates either wisely or poorly, but cannot transform their doings into "Ordnungspolitik."[8]

The quest is thus on for designing a monetary order in which the determination of interest rates would be left to the self-control of markets. It is of some interest here that Milton Friedman fiercely rejected any idea that central banks should try to pursue money supply "targeting" through orthodox interest rate policy. Pushing for his famous "k-percent rule," Friedman (1960, 1968) put much emphasis on implementation through direct money-base control. This was intended to reduce central bankers' degree of discretion literally to zero and prevent them from manipulating interest rates. Friedman's (1962) strong opposition

[8] Clearly, neither rule-based nor non-activist interest rate policies are any more "Ordnungspolitik" than any other type. Furthermore, attributing wisdom to keeping interest rates forever stable in a changing world is not only absurd from a Wicksellian-Keynesian monetary-theoretic viewpoint. Eucken's principle of "constancy of economic policy," too, cannot rationalize a "steady hand" interest rate policy, since blocking market adjustments through interventions in the market process makes nonsense of ordoliberal wisdom altogether.

to CBI was noted above. His favored monetary regime was designed as an autopilot system that would leave interest rate determination to the market process alone.

Did Walter Eucken and his Freiburg School devise practical proposals to implement their grand idea of "Ordnungspolitik" in the currency sphere that were equally consistent? In his *Grundlagen der Nationalökonomie*, Eucken (1940) rejected the traditional focus of monetary theory on the determination of the value of money as insufficient. Instead, theory should endeavor to explain how the economic process is conditioned by monetary factors. In his view, the role of money is far-reaching and lasting, as economic order and monetary order are interdependent. Stability of the unit of account is central to the overall coordination problem. This precondition together with the integration of the monetary system into the equilibrating mechanism of the economy would form the basis for the stability of economic processes, on his view (cf. Folz 1970).

Essentially, Eucken's famous principle of the "primacy of currency policy" reflects the same concerns that are at the heart of Keynes's (1923: xiv) observation that modern arrangements in production and finance "cannot work properly if the money, which they assume as a stable measuring-rod, is undependable." The difference is that Keynes went on to argue that a "managed currency" was *inevitable*, whereas Eucken (1949: 91) sought after an "automatically working monetary stabilizer" that could be implanted into the general order of economic competition as part of sound "Ordnungspolitik."

As far as the structure of the financial system was concerned, Eucken's (1946a) views on any required restructuring were radical. He generally sympathized with Irving Fisher's (1935) idea (or, "Chicago Plan") of strict separation between credit business and money creation; but disliked that this would make money-creating institutions completely dependent upon the central bank and therefore indirectly the state. An alternative scheme, due to Hans Gestrich (1936, 1944), which aimed at establishing a high degree of maturity matching among different kinds of banks, with each kind engaging in both credit and money creation, would have left the banking system more elastic too; an additional advantage in Eucken's view.

Of particular interest to us is an *unpublished*[9] report "On the nationalization of the central bank," in which Eucken (1946b) laid out his ideas on how the central bank might be integrated into the system of state control. In there Eucken compared two opposing solutions.

[9] I am indebted to Walter Oswald (Walter Eucken Archiv, Frankfurt am Main) for making this report available to me and granting me permission to quote from it.

An example of the first extreme of an independent central bank was provided by the German Bank Law of 1924. Despite its supposed advantage of blocking central bank financing of budget deficits, Eucken rejected it on the following general grounds: “an all too independent and weakly controlled central bank is difficult to fit into the structure of the state. It will be tempted to position itself in opposition to the general economic policy of the state. A “pluralism” will easily develop that would jeopardize the unity of state policy.” Examples for the other extreme were provided, in his view, by the German Bank Law of 1939 as well as contemporary tendencies toward nationalization (e.g. in England) that would integrate the central bank into the state apparatus. While forestalling the risk of pluralism in policymaking, this would invite inflationary risks due to free access to credit, in his view.

Eucken thus favored an interim solution. While retaining the central bank as an autonomous institution with monopolistic privileges, the central bank is to receive its statutes from the state and be subjected to “precisely specified state control, which would make it impossible for it to conduct its own economic policy against the state” (my translation). He identified the balance of power between Treasury and central bank as vitally important.

As currency arrangements may constrain both central bank and state discretion more generally, it is noteworthy that the early Eucken (1923) favored a gold currency but in his final years showed much sympathy for a “commodity-reserve-currency” regime along the lines of a proposal by Benjamin Grahams (1937). In his view, such a scheme would go a long way towards meeting his key endeavor of implanting an “automatically working monetary stabilizer” (Eucken 1949: 91) into the economic order of competition.

Given his reservations against the Chicago Plan (“not an automatism, but the will of these authorities regulates the money stock”; Eucken 1949: 79; my translation), one might at first suspect an important contrast here between Eucken and Friedman’s k-percent proposal. Yet, Friedman too did not want his favored scheme to depend on the authorities’ will (or whim), but proposed to oblige them *by law* to regulate money in a precisely specified way. The real difference is that whereas Friedman[10] denied any need for active manipulation by the central bank in order to counterbalance instabilities in the velocity of circulation (as held by the original proponents of the Chicago plan), Eucken saw merit in having some elasticity in the monetary system. At a deeper level, Friedman’s thought derived from a liquidity-

[10] I should say here: the Friedman of the famous k-percent rule. Friedman’s (1948) earlier “framework” featured a far more responsive money supply, due to a direct link to the budgetary position. Friedman’s later (1984) refinement went all the way to $k = 0$, amounting to locking up the central bank and throwing away the keys.

preference-theoretic version of the quantity theory and relied mainly on the "Keynes (interest rate) effect" (cf. Bibow 2000, 2002b) as equilibrating mechanism even in case of an inelastic money stock, whereas Eucken's more rudimentary quantity-theoretic thought stressed the (hoped-for) extra and more direct impact on the production of the commodities that form the bundle underlying the commodity-reserve-currency in that kind of regime. Interestingly, he found the supposed direct link between his favored "automatically working monetary stabilizer" and the *real* production sphere of the economy particularly attractive.

In any case, what these two liberals truly shared in common was the conviction that it should not be left at the authorities' whim to intervene in the market process. Interpreting Eucken's principle of "primacy of currency policy" as a call and justification for CBI is a nonstarter. Monetary policy is not elevated to the level of "Ordnungspolitik" simply by delegating interventions in the market process to independent central bankers. (Particularly, as there may be more than one way of maintaining price stability, including the simple-minded approach of inflicting protracted stagnation upon the economy.) As Friedman, Eucken too yearned for an automatically working monetary stabilizer, since anything else would generally ask too much from those human hands in charge: "Ignorance, weakness vis-à-vis interest groups and public opinion, flawed theories, all this influences the leaders much to the damage of the task they are entrusted with" (Eucken 1952: 257; my translation).

Eucken's concerns in this regard were generally shared by, and echoed in the works of, his pupils Friedrich A. Lutz (1935, 1936, 1949), Fritz W. Meyer (1938), and Leonhard Miksch (1948, 1949a,b,d). While the former two favored a gold currency as a solution to the issue, Miksch (1949b) devised a scheme that, while principally based on gold too, would also encapsulate an elastic element based on (trade) bills of exchange designed to adjust fully automatically. To be complemented by radical reforms in the financial system, the scheme was intended not only to make banks safe, but also to re-establish an order in which classical capital theory would hold, in his view. This brings out the fundamental issue most clearly: the role of the rate of interest as equilibrating market mechanism.

Echoing Eucken (1940), Miksch deplored that in a credit money system investment could run ahead of voluntary saving, so that the consumer-saver would be left out of the determination of the temporary structure of the economic process. In his envisaged system, by contrast, "capital can only be formed out of true saving. Correspondingly, the rate of interest is a true market price for the postponement of consumption, so that the consumer has complete rule over the economic process" (Miksch 1949b: 155; my translation). Clearly, if the key issue is that the consumer-saver should have complete rule over the economic process and interest rate determination be left to the self-control of markets, allowing central bankers, whether independent or dependent or anything else, to manipulate a non-automatic credit money apparatus through interest rate policies can hardly qualify as sound "Ordnungspolitik."

The Freiburg School is widely considered to, in important ways, also include F. A. von Hayek. The early Hayek was sympathetic to the commodity- reserve-currency idea too (see Hayek 1942), and his pupil Vera Smith (wife of F. A. Lutz) is best known for her critique of central banking and endorsement of free banking (see Smith 1936). But Hayek's later views, expressed in *The Denationalisation of Money*, are of particular interest. For they best illustrate yet another monetary *order* that seems fully compatible with liberal thought.

Hayek ([1976] 1990) proposed that private issuers of money should be free to choose and create their own favorite currency of denomination and, freely competing with state issuers, might perhaps best commit to keeping their issued currency stable in terms of some bundle of commodities (a remnant of earlier ideas). Hayek would leave it to the market to discover not just which currencies may be sound and safe, but also what the "optimal quantity" of money (Hayek [1976] 1990: 81) may be. Sharing Eucken's favor for some elasticity in money supply against Friedman's more rigid k-percent regime (cf. Fischer 1986), Hayek saw it as an additional advantage of his favored regime that "at the same time it would remove the necessity of making it fully automatic by taking the control from a monopolistic authority and entrusting it to private concerns" (48). Hayek too viewed a sound monetary order as key to the stability of the economic process. In the currency sphere too, however, he put his faith on competition. In his view, "*the past instability of the market economy is the consequence of the exclusion of the most important regulator of the market mechanism, money, from itself being regulated by the market process*" (102; italics in original). Making the thrust of his argument perfectly clear, Hayek welcomed that:

> With the central banks and the monopoly of the issue of money would, of course, disappear also the possibility of deliberately determining the rate of interest. The disappearance of what is called "interest rate policy" is wholly desirable. The rate of interest, like any other price, ought to record the aggregate effects of thousands of circumstances affecting the demand for and supply of loans which cannot possibly be known to any one agency. The effects of most price changes are unpleasant to some, and, like other price changes, changes in the rate of interest convey to all concerned that an aggregate of circumstances which nobody knows has made them necessary. The whole

> idea that the rate of interest ought to be used as an instrument of policy is entirely mistaken, since only competition in a free market can take account of all the circumstances which ought to be taken account of in the determination of the rate of interest (106-7).

In conclusion, our analysis of the Freiburg School on the issue of monetary order confirms that CBI is not at all compatible with Ordoliberalism. I see no basis for Bernholz's (1989: 208) assertion that "a minimal position exists, however, which would have been accepted probably by all German neo-liberals: an independent central bank obliged by law to preserve a stable currency."[11] Neither making sense in terms of theory nor offering an accurate account of history, Bernholz goes on to assert that: "It is thus not surprising that such a minimal solution emerged in the Federal Republic of Germany after the war" (208).

From an ordoliberal viewpoint, it is key to establish a monetary order that does not require and involve interventions in the market process. Whether Eucken's, Hayek's, or Friedman's proposed schemes might be practicable and in full compliance with their theoretical norms is another matter. The point is: Their respective proposals clearly show that these liberal thinkers envisioned radical reforms in order to comply with the principles which their aspired ideal of a sound monetary order would require. Empowering some monopolist—independent of political control!—with the right to fiddle with interest rates is probably the last thing that would present itself as safe and sound "Ordnungspolitik," from their viewpoint. And one might add here that regarding Eucken's principle of "primacy of currency policy" as justifying an independent central bank as chief intervener in the market process of interest rate determination would be just as fallacious, as it would be ludicrous to seek guidance for sound interest rate policies from his principle of "constancy of economic policy."

6. AN ALTERNATIVE KEYNESIAN CONCEPTION OF MONETARY ORDER THAT FELL THROUGH, TOO

Given the general disdain among Ordoliberals for any Keynesian ideas, it is perhaps something of an irony that Milton Friedman designed an "automatically working monetary stabilizer" that was much akin in spirit to Eucken's aspired monetary order, but based on Keynes' monetary theory. Another irony is that, contrary to a widespread presumption, ordoliberal thinking on what might represent sound "Ordnungspolitik" in the area of money,

[11] For once, Miksch (1949c) seemed to suggest CBI as a solution to a "perfect dilemma" in economic policy. Alas, without realizing the perfect self-contradiction he ended up with.

did not have *any* influence on actual developments in West Germany after WWII. The same may be said though about Keynesian views on this matter. While this section reveals that Keynesianism proved influential in the economics profession, including important advisory bodies, from early on, Keynesian ideas on the issue of political control over monetary policy had no decisive impact on actual developments either.

The proposition that "a managed currency is inevitable" (Keynes 1923) provided Keynes' starting point in all his monetary works. Throughout his life he considered monetary policy as one of the key "central controls" over the economic process within a system of "individualistic capitalism" encompassing a sophisticated financial system. The intention and approach was not to specifically plan and intervene in the allocation of resources. Rather, at issue was deliberate aggregate demand management, which Keynesians in general consider both inevitable and, as general and aggregate rather than specific intervention in the market process, "marktkonform" too (the German term here is "Globalsteuerung").

It is less well known though that Keynes also saw an important role for CBI in all this. When the Labor Party drew up a plan in 1932 that would have brought the Bank of England under the direct control of a cabinet minister (himself accountable to Parliament), Keynes objected to the plan. Stressing the need for a decentralized institutionalization of economic control and the role of special expertise in monetary policy, Keynes argued that the activities of a central bank consist of "the practice of a very difficult technique, of which Parliament will understand less than nothing. A planned economy will be impracticable unless there is the utmost decentralization in the handling of expert controls" (Keynes [1932] 1982: 131).

Confirmed in his other contributions on this issue too (see Bibow 2002a), Keynes saw it as the government's prerogative—under parliamentary control and within the legal limits prescribed by it—to lay down the main lines of economic policy, while interest rate policy should better be left to the monetary experts at the central bank. Expressed in modern terminology, he favored a monetary structure that featured instrument independence but goal dependence of the central bank. Within Keynes' favored scheme, Treasury and independent central bank would not be antagonists as in Vocke's vision, but partners cooperating to attain common goals as decided for them by the government of the day. Given that Eucken too denied the central bank any right to conduct its policy in opposition to the government, Karl Schiller ([1962] 1964), economics minister between 1966 and 1972 and a Keynesian with great respect for Eucken too, was right to point out that the central guiding principle of unity in economic policy ("Wirtschaftspolitik aus einem Guss") was shared by Keynes and Eucken.

On 18 September 1949, the scientific advisory committee of the economics ministry published its report "Monetary order and economic control" (Wissenschaftlicher Beirat beim BMW 1973), in which the committee briefly commented on the issue at hand. It advised that:

> "The unity of economic and monetary order requires a timely coordination between all authorities involved in economic policy. This also includes the central bank, since the aspired economic order cannot be realized without a corresponding monetary constitution and monetary policy. Within this framework of cooperation the central bank needs to be independent to the extent that it bears responsibility for the currency. This independence is to be protected by law" (my translation).

Unfortunately, the committee neither provided any more specific guidance on how this kind of independence should be organized so as to secure cooperation at the same time. Nor did it further rationalize the need for this kind of independence in the first place.

What seems most remarkable though, particularly in view of the fact that the committee included various members of the Freiburg School[12] (or at least with ordoliberal leanings), is that the committee accepted that the practical nature of monetary policy would have to be of an ongoing discretionary type rather than one-off "Ordnungspolitik":

> "Whether an automatically working monetary order could be realized might be left on one side. Under existing conditions the manipulation of the quantity of money will be necessary in any case. It should set itself the aim of allowing the development of production and turnover under avoidance of inflationary or deflationary processes. This is not possible through a one-off institutional change of the current monetary organization, but requires a very particular monetary policy on a continuous basis" (Report of 18 September 1949, Wissenschaftlicher Beirat beim BMW 1973; my translation).

It is also noteworthy that the committee considered both employment and price developments as relevant and suggested that monetary policy has to be guided no other than by an analysis of the whole economic situation. There is no denying that a monetary order of this kind would grant the central bank significant discretionary powers, which is important in view of the committee's call for policy coordination and unity in economic policy.

As the debate on the Bundesbank Act progressed over the years, the committee was called upon by Ludwig Erhard's economics ministry (which by that time had taken over responsibility for the Bundesbank Act from the finance ministry) to offer its expert opinion on the matter, which it duly did in its "Recommendations and preliminary opinions" of February 1954 (cf. Becker 1982). In there the committee tackled in a fairly precise way with

[12] The committee included, for instance, Walter Eucken (until his death on 20 April 1950), Franz Böhm, Adolf Lampe, Leonhard Miksch, Erich Preiser, Theodor Wessels, Erwin von Beckerath, and Alfred Müller-Armack.

the central bank's role and tasks and how its independence in fulfilling its job might best be organized.

The committee rejected a return to gold or any other precise and rigid norm for the bank. But it argued that for the purpose of coordination with economic and fiscal policies laying down particular guidelines would be "necessary," and that linking economic and monetary policies would justify a "legal rule." Proposals for such a legal rule were discussed which would limit the central bank's room for maneuvre without specifying its goals in more concrete terms. The committee (now including later economics minister Karl Schiller too) ended up recommending the following formula:

> "The central bank has to orientate its monetary and credit policy in the interest of steady growth of the economy is such a way as to keep the purchasing power of the DM as far as possible stable, in a way that monetary and credit policy contributes to the employment of all resources, and that the balance of payment may balance on the basis of free international trade" (repr. in Becker 1982: 73; my translation).

The crucial point about this proposed formula for the Bundesbank Act is that the central bank's foreseen remit was equivalent to what the committee had in mind as orientation for macroeconomic management in general anyway. (In fact, it was also equivalent to what was eventually laid down in the SGA of 1967; see below.) Monetary and economic policy generally would thus have been bound by a common rule and be geared at common goals to be pursued in a coordinated fashion. Put the other way round, the central bank was not supposed to be goal independent or pursue its own goals. The committee's primary concern was to constrain the central bank's independence in appropriate ways to achieve that very end. Only in so far as its exclusive responsibilities in the sphere of its technical competence was concerned, the bank would be [instrument!] independent from any instructions:

> "In the application of its set of instruments and operations the bank is not subordinated to any instructions from the government. In its decision on the optimal compromise between the [aforementioned] three policy goals the bank has to take the general economic policy of the government into account" (repr. in Becker 1982; 73-4; my translation).

As it turned out, however, the committee's views had no decisive influence on subsequent developments. It was never even consulted again on the issue. One reason may have been that it recommended a comprehensive Enquete commission for a thorough investigation into the issue, which conflicted with the ministry's timing plans. Another that the committee in a somewhat controversial way also recommended conserving the system's decentralized structure, which conflicted with Erhard's own views on the matter. But the key fact remains nonetheless: in the mid 1950s Erhard's advisory council designed and recommended an essentially Keynesian structure of monetary policy, which would have altered the situation that had become established with the "Übergangsgesetz" of 1951.

7. LUDWIG ERHARD AS FIGHTER FOR THE BUNDESBANK'S INDEPENDENCE?

As economics minister of the "Bizone" and in the context of the currency reform of 20 June 1948, Ludwig Erhard was responsible for the "Leitsätzegesetz," which according to Kloten (1997, 163; my translation) "was the hour when West Germany's market economic order was properly born." Later, as economics minister of the Adenauer government, Erhard attained fame as the mastermind behind the "Wirtschaftswunder" (economic miracle). It is generally attributed to Erhard that he held ordoliberal views and was a strong proponent of CBI too. After all, when the Bundesbank Act was finally passed in 1957 and the Bundesbank's independence properly enshrined in the law, this occurred under his ministry's control.

Indeed, it is quite easy to cite Erhard in ways that would clearly seem to substantiate his supposed credentials as proponent of CBI. For instance, when asked by Adenauer in November 1949 to comment on a letter by Vocke, Erhard stated that he agreed with Vocke that trust in the stability of the currency was fundamentally based on the independence of the central bank: "As to the relationship between the Federal government and the BdL or the CBC, I am generally of the opinion that the legal autonomy or independence of the central bank must not be touched. This principle has always proved prosperous" (BA 136/1999; my translation). In 1956, he then proclaimed: "The formula "dependent central bank = inflation" holds always and everywhere" (BA 102/12595,2; my translation).

Alas, the matter is far less clear than it may at first appear from such seemingly compelling evidence. For reading these observations in context reveals that Erhard, too, was convinced that final responsibility and power to determine economic and monetary policy rested with the government, *especially its economics minister*.[13] What he rejected was that the government might *by law* be placed in a position to give instructions to the central bank. In Erhard's view, the government's influence should not flow from any legal right to give direct

[13] Erhard's biographer Volker Hentschel (1988, 1996) reached a similar conclusion on this issue.

instructions, but—far more opaquely—hinge upon the economics minister's powers of persuasion in dealing with the (government-appointed) personalities of the bank's leaders.

It is worthwhile considering Erhard's views on the CBI issue in relation to his position within the government. For one thing, as long as Schäffer's finance ministry held the leadership role within the government vis-à-vis the central bank, strengthening the finance minister's grip on the bank, if anything, might have further weakened his own position; particularly as Erhard's position was far from secure in the early 1950s. This factor by itself made Erhard a natural defendant of the bank's independence. For another, even when Erhard had gained the upper hand vis-à-vis the finance minister later on, there was still the Chancellor's attitude to be checked, representing another stumbling block for Erhard's own ambitions. It is true in this context that Erhard repeatedly warned Adenauer on the latter's public attacks on the BdL, which Erhard considered risky and counterproductive. Yet, Erhard may have simply understood that if Adenauer's ambitions for more explicit government control over the bank were to prove successful, the power would have been grabbed by Adenauer himself; whereas if any public conflict between Adenauer and the BdL backfired, this would tend to weaken the government's position as a whole, including his own.

No doubt West Germany's very power-conscious first Chancellor, Konrad Adenauer, thoroughly objected to his lack of power over the bank. This is as clear from the early stages of negotiations that led up to the "Übergangsgesetz" of 1951, as it is for the final stages in 1956. Essentially, he considered the arrangements foreseen in the draft law under discussion at the time as being in contradiction to the Grundgesetz. The minutes of the cabinet meeting of 11 July 1956 depict Adenauer's position as follows:

> "Article 3 of the draft would allocate securing the currency as an independent task to the Bundesbank. This task, however, constituted an inalienable part of the government's responsibility for general economic policy. If besides the draft's Article 3 (2) only instructs the bank to support the government's economic policy within the framework of securing the currency this would concede primacy for safeguarding the currency over general economic policy and entitle the central bank with an autonomous decision on the case of conflict. Such a regulation would conflict with the Grundgesetz. … the Bundesbank would be the primary authority of control, at least in the sphere of monetary policy, although it is not politically accountable to anyone. That would concede to the central bank a position of authority within the state, which could oppose the political authorities" (Cabinet Minutes 1956: 474-6; my translation).

Subsequent to these discussions the relevant provisions were redrafted so as to appease Adenauer. In particular, safeguarding the currency became a shared responsibility of both the government and the Bundesbank, while the bank's independence from government instruction was reserved a less prominent place in the act. However, just as Adenauer had reached agreement on the matter within his cabinet, the proposed new construct and balance of power foreseen therein met opposition in both chambers of parliament. Apart from still pushing for conserving the (Allies-imposed) decentralized organization of the central banking system, the Bundesrat particularly demanded that the Bundesbank's independence should be more explicitly emphasized. At the law's first reading in the Bundestag the speaker for the Social Democratic Party in opposition expressed the same desire.

Curiously, this was Walter Seuffert, who in the parliamentary discussion on the "Übergangsgesetz" in 1951 had articulated concerns about the somewhat insecure position of the government vis-à-vis the bank. The year 1957, when the Bundesbank Act was finally passed, was also a year when federal elections were held. In May of the year before, Adenauer's public attack on the BdL's rate hikes (famously known as the "Gürzenich affair") provoked solidarity with the guardian of the currency from all round. Thus, hardly unwelcome to the central bankers, at the final stage of hammering out its legal status the bank's position was bolstered by public opinion. In the end, the government's responsibility for safeguarding the currency was dropped again by the mediation committee of the two chambers of parliament (arguing that this would go without saying), while the Länder managed to retain their overweight position as far as appointment of the bank's leadership was concerned.

One could hardly go wrong in concluding that Adenauer's ambitions had failed, if not backfired: the Länder and the left-wing opposition felt compelled to protect the bank's independence against the Chancellor's grip. As a result, the preliminary construct of 1951 was essentially retained in the final law, except for its even more explicit emphasis on the bank's independence and some federal government say in the appointment process of its leadership. This legalized a role for the central bank which Adenauer had not only feared, but considered in conflict with the Grundgesetz too: a public authority of executive powers that could oppose the government at its own discretion but without accountability to anyone.

As Erhard was probably aware of Adenauer's impact on public opinion and on the balance of power between the government and the bank, he avoided public confrontations with its leaders. Preferring more opaque channels of influence, it is of great interest that Erhard insisted in 1954, when West Germany joined the IMF and the relationship between the BdL and the government as regards exchange rate matters (a matter in the economics ministry's sphere of responsibilities) had to be settled, that the government must reserve the final word for itself (cf. Cabinet Minutes 1954: 43-4, 16th meeting on 29 January 1954).

Exchange rate issues turned out to be the bone of contention between the government and the bank on many a subsequent occasion. Enjoying some degree of freedom in the 1950s even within the Bretton Woods regime, capital flows became an increasingly important factor in monetary policy with the full convertibility of the D-Mark since late December 1958. In 1961, in applying his powers of persuasion on the personalities ruling at the bank, Erhard expressed another brisk formula on the CBI issue that is of some interest here. He declared that "independence of the Bundesbank presupposes that a common line will be found."[14] Succeeding Adenauer as Chancellor in 1963, Erhard's fall as such in 1966 is viewed by some as having been linked to the Bundesbank's highly esteemed president Karl Blessing in particular (Caesar 1981, Holtfrerich 1988, 1998). (Some believe he may not have been the only German Chancellor struck by the same destiny; Marsh 1992.) Deliberately engineered by the Bundesbank (Girsch *et al* 1992: 144-5), West Germany's first recession (since the crisis of 1950-1) in 1966-7 also marked the beginning of the Keynesian era of "Globalsteuerung."

8. KARL SCHILLER AND THE STABILITY AND GROWTH ACT OF 1967: BELATED KEYNESIAN TRIUMPH?

The crucial cause for conflict immanent in both the "Übergangsgesetz" of 1951 and the Bundesbank Act of 1957 may be pinpointed here. The particular form of independence established in there, by defining the central bank's goals and its duties to cooperate with the government in vague terms only, endows the bank with a huge degree of discretion. This may quite easily provoke tensions with the government which, inevitably, bears ultimate responsibility for economic and monetary policy. In fact, the flaw in this monetary structure is that it risks setting the incentives and interests of the two players on collision course.

The government might tend to lose its own political interest in maintaining price stability, if success at that front only benefits the central bank's prestige anyway; while, at the same time, being forced to push its policies in other directions by at least as much as its prestigious antagonist might allow at any time. Matters are made worse should the central

[14] Minutes of CBC Meeting of 30 May 1961, p. 13, Buba HA B 330/178, (cf. Berger 1997: 201). My translation.

bank succeed in defining its own public prestige in terms of price stability only. For this might encourage complete denial of any adverse effect on other policy goals due to "its own success" with respect to "its own primary goal." In line with Wilhelm Vockes' vision, government and bank are positioned as antagonists rather than partners in the pursuance of common goals.

Given that the Bundesbank Act left the substance of the bank's independence essentially undefined, the actual relationship and balance of power between the government and the central bank within the state was thereby left to be determined in the course of action —a game to be played though within this particular set-up. As the outcome would depend upon public perceptions, it was in the central bank's institutional self-interest to act even more as a political player in its own right in order to woo public opinion; even if this came at the government's expense. Particularly, as its power and independence was only protected by simple law, which, in principle, could have been easily changed by parliament at any time.[15]

Other researchers noted the bank's efforts in this regard. "The Bundesbank has always tried to influence public opinion," Berger and de Haan (1999, 17) observed, for instance. Its head start in the newly founded West German state and its early gained prestige formed the bank's capital against competitors in the political arena: "Far more important .. was the social support for the principle of central bank independence. In the BdL's first ten years, its success in maintaining price stability had won substantial praise from a society enjoying the benefits of economic success. This popular support … proved critical in limiting the government's influence over the structure and, hence, the future policies of the central bank" (Goodman 1992: 40). In fact, some Bundesbank leaders were quite open about the objectives and successes of the bank's public relation efforts:

> "From the beginning the German central bank undertook great efforts on her own to foster the public's understanding and support for stability-oriented policy. This was at the same time necessary to put the independence of the central bank on a firm basis. … [I agreed with Eduard Wolf] that the independence of the Bundesbank would only be secured if it was supported by approval from the vast majority of the population; only then would it be protected against attacks from the political side. Furthermore we said: If the Bundesbank is neither accountable to the government nor parliament, in a democracy it then has to render public account to the people. So we decided to advertise for the appreciation and support of the central bank by means of busy publication activity" (Emminger 1986, 26-7; own translation).

[15] According to Stern (1992) it was only with the German Constitutional Court's ruling on the Maastricht Treaty in 1992 that the Bundesbank's independence became constitutionally guaranteed.

This kind of advertisement for its own position not only represents a dubious form of public accountability. It may be particularly prone to drive a wedge between the government and the central bank, and thus risk undermining the unity in economic policymaking, which Walter Eucken held was the overriding principle in any sound economic order.

Caesar's (1981, p. 202) observation that "public discussion in Germany perfectly taboos the principle of CBI" (my translation) is thus of great interest. Public confrontation between Chancellor Adenauer and the BdL in 1956 proved as conducive to mobilizing public support for the bank's independence in the final stages of negotiating the Bundesbank Act of 1957, as they had done earlier in the context of the "Übergangsgesetz."[16] In the parliamentary debates on the Stability and Growth Act [SGA] of 1967 economics minister Karl Schiller considered it necessary to repeatedly emphasize that the Bundesbank Act was *untouchable*.

Karl Schiller and the SGA are widely seen as marking the (belated) triumph of Keynesianism in German economic policymaking (Abelshauser 1991). While following Eucken in generally rejecting government (micro) interventions in specific market processes, Schiller (1966) held that macroeconomic demand management ("Globalsteuerung") aimed at stabilizing aggregate economic activity was equally necessary to safeguard the market economy. The SGA legally declared the very set of goals that featured in Erhard's Advisory Council's deliberations of the mid 1950s to be the key goals of general economic policy. Since the Bundesbank's independence was untouchable, however, the brief phase of Keynesianism in Germany, which allegedly began in 1967, did not include monetary policy.

Note that Milton Friedman gave his famous presidential address to the American Economics Association in 1967 too, widely seen as marking the beginning of the triumph of monetarism. Some years earlier Friedman had declared that:

> "The central problem is not to construct a highly sensitive instrument that can continuously offset instability introduced by other factors, but rather to prevent monetary arrangements from themselves becoming a primary source of instability. What we need is not a skilled monetary driver of the economic vehicle continuously turning the steering wheel to adjust to the unexpected irregularities of the route, but some means of keeping the monetary passenger who is in the back seat as ballast from occasionally leaning over and giving the steering wheel a jerk that threatens to send the car off the road" (Friedman 1960, 23).

Whether Keynesianism enjoyed any real triumph in Germany in 1967 may be just as debatable as the idea of monetarism's triumph in the practical affairs of central banking. It seems as if Friedman's views on what might constitute a sound monetary order were

[16] Berger (1997a,b) emphasizes the role of conflicts, especially the "Gürzenich affair" of 1956.

similarly ignored as those of Eucken: central bankers have become ever more firmly and cosily seated behind the economy's steering wheel. All around the world central banks continuously interfere in market processes by conducting, however guided, interest rate policies. In one way or another, they are part of the political process of modern democracies too. Some forms of independence may be observed that even seem to grant the central bank a legal right to oppose any democratically elected government at their discretion.

In Germany, Karl Schiller's fall as "super-minister" in 1972, too, (when he, unusually, headed both the finance and the economics ministries) occurred in the context of his public confrontation with the Bundesbank. Katzenstein (1987, p. 97) vigilantly observed that the bank might have had an interest "in eliminating a personal rival who appeared in the process of building a countervailing institutional power base." Yet, if the guardian of the currency is generally held to cause no harm whatever in pursuing its own primary goal of price stability, any critic of the bank will automatically be seen as an attacker on the public good of a sound currency. In fact, in explaining its conduct solely in terms of its commitment to price stability few might suspect that the bank's self-interest, foremost in protecting its own independence and power, might ever play any role at all. Germany's post-war monetary history provides an illuminating case study of the evolution of central banking institutions and traditions within the realm of an intricate political power struggle. As far as the role of economics is concerned, the peculiar German tradition of an early emphasis on CBI paired with stability-orientation in policy does not seem to have any firm basis in contemporary German monetary thought. Historical accidents and the peculiar personalities involved, especially their abilities to mould public perceptions in line with their interests, appear to have been more important.

9. CONCLUSION

Allied decentralization policy had a lasting impact on the federal structure of West Germany's central banking system. As far as the country's famous CBI tradition is concerned, however, that was of peculiarly German origin and design. The tradition started with the interim law of 1951, then became fully legally confirmed in the Bundesbank Act of 1957, and has not been touched ever since. This contrasted with the initial status of the central bank as one of all-comprehensive dependence upon Allied control, exercised through the ABC.

The point is that at the time of the BdL's establishment, the bank could hardly have been made dependent upon German control, as no federal government existed yet. It also meant that the BdL was blessed with a head start and from early on busy, engaged in building up its own reputation. Its position was further strengthened by the fact that when the first federal government entered the play, the newcomer also had to deal with the vested interests of the Länder. While the Allies' policy of federalization thus influenced the outcome of the bank's independence after all, albeit indirectly, it can also be said that the bank played its cards rather well. As the body politic got quickly caught up in power fights among itself, it is curious that the bank seemed to emerge ever more powerful from public conflicts with its political master—its independence gaining the "untouchable" status in due course.

Most surprisingly, perhaps, the analysis shows that considering Ordoliberalism as the source of inspiration and theoretic basis of this peculiarly German tradition of CBI has no basis. The Freiburg School is generally held to have been a decisive influence in shaping West Germany's economic order and its "miraculous" performance. Yet, the postulate of CBI stands in stark conflict with anything Walter Eucken and his pupils had to say on what might constitute a sound monetary order. For delegating interest rate policy to independent central bankers does not transform regular interventions in the market process into "Ordnungspolitik."

Contrary to another widely held view, Keynesian ideas too left their mark on Germany's economics profession from early on. In this regard it is of particular interest that, in the mid 1950s, Erhard's Advisory Council designed and recommended a model of CBI that was essentially Keynesian in spirit. The council specified that the bank should be instrument independent, but otherwise focused its efforts on constraining the bank's discretion and securing cooperation with the government. Failing to make an impression at the time, the "legal rule" proposed for the set of goals to be pursued by the government and central bank in cooperation later on made its way into the Keynesian SGA of 1967. By that time, though, the Bundesbank Act and the bank's independence had attained a status of being "untouchable."

Contemporary economic theory thus had no decisive influence on Germany's peculiar CBI tradition paired with a so-called stability-orientation in monetary policy. Arguably, this tradition may be in conflict with principles of democracy as well as market-theoretic considerations; an issue on which a fair amount of agreement between Keynesian and ordoliberal (as well as monetarist) thought is discernible. Perhaps the central bank's role as a political actor in its own right and in carving public opinion should not be underestimated in explaining a peculiar German tradition that was finally exported to Europe in the 1990s.

One important issue—and task for future research—is to investigate whether and to what extent Germany's peculiar monetary traditions may have proved conducive to Germany's economic performance in the past, as conventional wisdom has it, which conditioning factors might have played an important role in producing the historical record, and whether some peculiar setting might be easily replicable at the European level. Another issue is to realize that a central bank's public relation efforts, apart from its primary goal of wooing the general public, may also have secondary targets in focus, like the economics profession itself, for instance. On this link Peter Johnson vigilantly observed:

> "Indeed, perhaps even more than the German state itself, the principal beneficiary of its efficient mobilization of expertise was the prestige of the Bundesbank. While American monetarists failed to alter the independence of the Fed, the Bundesbank converted the next generation of economists to the cause of independent central banks, albeit with a foreshortening of political vision that comes from over emphasizing independence as the crucial factor for success. This legacy in enhancing the prestige of independent central banks among economists on opposite sides of the ocean illustrates the powerful influence that epistemic politics can have on researchers themselves. It would be naive to suppose that the greater success and durability achieved by monetarism (especially in the Bundesbank) has not also had an impact on analysts of comparative public policy" (P. A. Johnson 1998: 18).

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