The fading miracle provides a lucid account of economic policy in West Germany from the late 1940s up to the present, and has been carefully updated to include a survey of the way Germany has reacted to the new challenges presented by the unification of the two German states in 1990. Five distinct eras are covered: the early post-war misery ending with the celebrated liberal reforms of June 1948 which laid the ground for the so-called social market economy; the miraculous growth spurt in the 1950s; the golden years of full employment and demand management from the early 1960s up to the worldwide caesura of the first oil crisis in 1973; the fifteen years of slack growth thereafter; and, most recently, the dramatic political and economic unification which set up a challenging new agenda for policymakers.

For all these five periods, the authors describe and evaluate the major policy controversies and decisions as well as the actual path of economic history. Particular emphasis is placed on the characteristically German institutions of policy counselling and their role in policy formation. Although the book mainly addresses students of economics, it is most valuable reading for anybody with a keen interest in economic policy matters and the economic history of Europe.
Cambridge surveys in economic policies and institutions

The fading miracle
Four decades of market economy in Germany
Cambridge surveys in economic policies and institutions

Editor
Mark Perlman, Professor of Economics, University of Pittsburgh

Economic ideas are most obviously revealed through economic policies, which in turn create and are implemented by economic institutions. It is vital, therefore, that students of economics understand the nature of policy formation, policy aims, and policy results. By examining policies and institutions in a detailed yet accessible manner, this series aims to provide students and interested lay-people with the tools to interpret recent economic events and the nature of institutional development, and thus to grasp the influence of economic ideas on the real economy.

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Four decades of market economy in Germany

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Preface

This book is an essay in applied economics, not in economic history. To be sure, history is its subject matter, but the main interest of the authors – all of them economists – was to describe and evaluate a long chain of events in the light of their own economic understanding. Hence, the book is addressed above all to students of economics and interested laymen, not necessarily professional historians who would like to learn new facts about West German post-war economic history. The reader we have in mind should be familiar with the basic tools of economic reasoning and should have a keen interest in history; no more is required.

Reality can hardly be understood unless it is deliberately simplified by abstraction. We had to abstract from numerous facts and relationships that others might have wished to stress. Admittedly, the choice is subjective: idiosyncrasies may have come in, though we tried to avoid them. No doubt, Marxists would have seen things through different conceptual glasses. But we believe that our ‘individualistic approach’, which regards markets rather than classes as the decisive force of economic history, yields a quite consistent interpretation of actual events, at least in the case of West Germany since the Second World War.

In our view, the main lesson comes down to one fundamental proposition: miracles emerge when spontaneity prevails over regulation, and they fade when corporatist rigidities impair the flexibility for smooth adjustment. At the time of writing, dramatic developments in Central and Eastern Europe gave rise to a renewal of beliefs in market spontaneity, thus tentatively confirming our own views and hopes. The 1990s will provide further tests of our proposition in Western as well as in Central and Eastern Europe. But one can speak of miracles only when favourable developments come as a surprise. Where they are desperately longed for, as they are now in the eastern part of the (re-)united Germany and elsewhere in Central and Eastern Europe, they will be seen as the fulfilment of justified hopes. And they may not emerge as easily, since hungry people are tempted to eat the fruits before they are ripe.

Not only the miracle, but also the fading of the miracle provides important lessons. Corporatism and bureaucracy are strong forces, leading
potentially everywhere to a politicization of economic life. For a while, they may be held back or brought into service of rapid market growth when people or the public can be made to believe that distributional quarrels will close growth opportunities to the detriment of all, eventually leading to a zero-sum society. But politicians, bureaucrats and leaders of corporatist organizations have too short and too partial a view to meet the concerns of market-orientated economists. No doubt, the narrow interests of the practitioners of the corporatist system will often gain the upper hand, so that the economy is bound to slow down under the impact of mounting regulations and higher taxes, rising costs and shrinking profit margins.

External economic relations may serve as an accelerator. As we observed, this holds true in a slowdown as much as under conditions of fast growth. Trade liberalization in an upswing helps to enhance the supply responsiveness of a domestic economy under demand pressure; and allowing more imports to come in facilitates import liberalization in other countries. Such market integration amounts to a widening of the scope for gainful specialization – from an inter-industry to an intra-industry division of labour. Much mutual learning and much technology transfer go along with this process. In reverse, we observe induced protectionism emerging under conditions of relative stagnation; it makes matters worse.

In interpreting West German post-war economic history and policy along these lines, we found no basic contradictions between the course of events and the teaching of the great Ordoliberal Walter Eucken, who, half a century ago, stressed the link between theoretical reasoning and institutional description in the form of what he called thinking in ‘economic orders’, in types of institutional settings or frameworks.

Naturally, there is a basic methodological shortcoming. Economics correctly advises us to think in terms of opportunity costs, i.e. to compare alternatives. Interpreting historical events, imputing consequences to ‘causes’, any kind of valuation and any assessment would thus require counterfactual analyses. To be honest, if we made them, we mostly kept them at the back of our minds. The reason is simple: there are always far too many alternatives, including some possibilities one can think of only with the benefit of hindsight and some which have never been discussed anywhere.

As far as the period of the West German economic miracle – i.e. the late 1940s and the 1950s – is concerned, we believe that events took a course for which there was hardly any better realistic alternative. But for the slowdown we cannot be so sure. The senior author’s record of (mostly unheeded) advice and policy criticism reminds him of some alternatives that appeared to be better ex-ante. Would they have also turned out better
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ex-post? The answer is that we just cannot know with any degree of certainty. Alternative paths of history are as hypothetical as ex-ante descriptions of alternative policy proposals sometimes demanded by policy-makers in the interests of keeping their freedom of choice. And just as an ex-ante discussion of policy alternatives can raise the intellectual level of the economic policy debate, we feel that counterfactual historical analysis may be worth more intellectual effort than could be invested in writing this book. Nevertheless, readers interested in such counterfactual reflections will find fertile ground in numerous passages referring to the actual policy debate.

In recent years, the progress of history even outpaced the work on this book. When the authors started to write the initial drafts, the unification of divided Germany was still a distant dream; by the time we put the finishing touches to the manuscript, East Germany had already merged with the West. For this fortunate and originally unforeseen reason, this book covers the entire time span in which West Germany existed as a separate economic entity with its own particular economic policies (mid 1948 to mid 1990) and the brief time span of the post-war chaos (1945 to mid 1948) which preceded the formation of West Germany.

By its very nature, an essay in applied economics should not be structured like a piece of historiography: the thread of economic reasoning all too often requires a deviation from historical chronology. Therefore we subdivided West German post-war history into four periods – 1945–8, 1948–60, 1960–73 and 1973–89 – each of which can sensibly be treated as a period with its own characteristic problem setting. For reasons of analytical convenience, we dealt separately with the domestic and the international aspects of economic policy in each of these periods (except the very short first one). Needless to say, such a separation of issues must remain to some extent arbitrary, because, in actual practice, domestic and international matters are often closely intertwined. Nevertheless, we think that the opportunities, challenges and pressures emanating from international trade and finance have been important enough for West Germany’s economic development to deserve a somewhat extensive and thus separate treatment. The dramatic events of German unification in 1990 are covered in a separate chapter, the only one that has been updated and revised for the paperback edition. All major sections of the book are self-contained: the reader who is short of time may turn to any of them without prior digestion of the preceding paragraphs. This is why we deliberately allowed for some minor overlapping of issues between the sections.

Writing this book would have been impossible without a basic consensus among its authors. This consensus led to a virtually unlimited mutual confidence during the drafting period and helped to avoid counterproduc-
Preface

tive disputes when the drafts were subjected to scrutiny. The book may be considered a by-product of learning from each other during a period of more than five years. Only if the book’s gestation period is taken to be so long as to include several workshops under his auspices could the senior member of the team accept a fair share in whatever credit may be associated with its authorship.

As any economist knows, a division of labour can be highly productive: it saves costs and raises output per unit of time. Applied to interpersonal cooperation, the division of labour can also help to improve product quality. Should this apply to this book, the authors would feel reassured. Naturally, the division of labour had a wider scope. It included the participants of various workshops devoted to the subject, notably Christoph Buchheim, Gerhard Fels, Stephan Heimbach, Renate Merklein, Karl Schiller and a large number of associates of the Kiel Institute of World Economics, in particular Alfred Boss, Joachim Fels, Erich Gundlach, Henning Klordt, Enno Langfeldt, Joachim Scheide, Stefan Sinn and Frank D. Weiss. Some of them prepared papers illuminating certain aspects, developments or episodes; others made specific points to correct our judgements. Of course, the usual disclaimer applies: any remaining shortcomings are the sole responsibility of the authors.

Finally, we are indebted to Andreas Freytag and Thomas Ilka for research assistance, to Simone Schmieding for taking care of the manuscript, and to Thomas Tack for supporting our editorial efforts. We also thank Patrick McCartan and Pauline Marsh of Cambridge University Press for their excellent cooperation in the final stages before publication. The whole enterprise has greatly profited from the intellectual atmosphere and the facilities of the Kiel Institute of World Economics.