

Contents

Presidential Preface. <i>By Hans Tietmeyer</i>	xxiii
Foreword. <i>By Otmar Issing</i>	xxv

Part One LEGACY AND FRESH START

I. The Reichsbank 1876-1945. <i>By Harold James</i>	3
1. Introduction	3
2. Designing a central bank	3
3. The practice of central banking	13
4. Inflation and hyper-inflation	17
5. Deflation and depression	24
6. The Reichsbank and the economics of control	31
7. The Second World War	41
8. Conclusion	48
9. Sources and bibliography	49
II. The Establishment of the Bank deutscher Länder and the West German Currency Reform. <i>By Christoph Buchheim</i>	55
1. Introduction	55
2. The general economic situation in western Germany before the currency reform	56
a) The state of manufacturing industry	57
b) The lack of any serious incentive to produce	59
3. The German banking system in the early post-war years	62
4. Allied reforms of the central bank structures in West Germany	67
a) Inter-allied negotiations on the banking system	67
b) The Land Central Banks	68
c) The Bank deutscher Länder as the central bank of the Land Central Banks	74
5. The currency reform	80
a) German and American plans for currency reform	81
b) Currency reform negotiations in the Control Council	85

c) The currency reform in western Germany	90
d) Currency reforms in the Soviet Zone of Occupation and West Berlin	93
e) Economic reform in western Germany	94
f) The consequences of currency and economic reform	95
6. Sources and bibliography	97

Part Two

THE CENTRAL BANK IN THE
CONSTITUTIONAL AND FINANCIAL SET-UP
OF THE FEDERAL REPUBLIC OF GERMANY

III. The Note-Issuing Bank within the State Structure. <i>By Klaus Stern</i>	103
1. Introduction	103
2. The constitutional status of the Bundesbank as a currency and note-issuing bank	104
a) The criteria set by constitutional law	104
b) Statutory allocation of functions	108
c) Role of the Bundesbank as a constitutional body	108
d) Highest executive body of a special kind	110
3. The Bundesbank Act dated 1957 and its further legal development	111
a) The three fundamental decisions contained in the Bundesbank Act	111
b) The amendments made to the Bundesbank Act as a result of German reunification	115
c) Changes to the rights and status of the Bundesbank through the legislation of the European Union	118
4. The organization of the Bundesbank	121
a) The governing bodies of the Bundesbank	121
b) The pluralism of the appointing institutions	123
c) Other agencies and employees of the Bundesbank	124
5. Duties, powers, and policy instruments of the Bundesbank	126
a) The statutory allocation of duties	126
b) Main aim: safeguarding the currency	128
c) The monetary policy instruments and their legal qualification	129
d) Problems posed by legal protection against measures carried out by the Bundesbank	135
e) The participation of the Bundesbank in banking supervision	137

f) The involvement of the Bundesbank in national and international economic, financial, and business cycle policy	139
6. Independence and relations with national governing bodies as a constitutional basic issue facing central banks	144
a) The constitutional and political significance of the problem	144
b) Independence in accordance with the Basic Law	144
c) The corresponding structure of independence under the Bundesbank Act	148
d) The Bundesbank and the Federal Government	151
e) The Bundesbank and parliament	155
7. Bibliography	158
 IV. Public Finance and the Central Bank. <i>By Wolfgang Kitterer</i>	165
1. Introduction	165
2. The problem of budget surpluses in the 1950s	168
a) The fiscal policy environment	168
b) The 'Julius Tower' and monetary policy	170
c) The failure of anticyclical fiscal policies during booms	171
3. Changes and reforms in the 1960s	172
a) The road to budgetary reform	172
b) Fiscal reform: between unitarianism and federalism	175
c) Conflicts between fiscal and monetary policy	176
d) The breakthrough of anticyclical fiscal policy in the 1966-7 recession	180
4. Growth and inflation in the early 1970s	183
a) Growing collective needs of the affluent society	183
b) The distribution struggle hots up	184
5. Hopes of, and undue demands on, monetary and fiscal policies (1973-82)	185
a) Fiscal and monetary policy under a floating exchange-rate regime	185
b) The search for new solutions after the first oil crisis	188
c) Demand management shows signs of strain	189
6. Consolidation and coordination in the 1980s	192
a) The changeover to supply-side economics	192
b) Consolidation between demand risks and stimulated supply	194
c) The growing need for the international coordination of economic policy	197
d) Limited cooperation in the interests of a stable currency	199

7. Double unification: Germany and Europe	200
a) Adjustment problems posed by the financing of German unification	200
b) The failure to consolidate public sector budgets	203
c) Tensions in the European Monetary System	205
d) The fiscal convergence criteria of the Maastricht Treaty	207
e) The risks of short-termism in debt management	210
8. Bibliography	212
V. The Bundesbank and Financial Markets. <i>By Günter Franke</i>	219
1. Caught between safeguarding the value of money, financial market stability, and free competition	219
2. The German banks	221
a) The banking system in Germany	221
b) The economic importance of the banks	222
c) The emergence of new financial intermediaries	225
3. The Bundesbank's services for domestic credit institutions	228
a) Refinancing	228
b) Provision of information	229
c) Provision of payment services	230
The automation of the payment system	230
Limiting payment risks	231
4. The impact of the Bundesbank's interest rate policy on the financial markets	233
a) The Bundesbank's instruments of interest rate policy	233
b) Expected reactions in efficient financial markets	234
c) Empirical findings	235
The shifting interest rate policy environment since 1948	235
Reactions to changes in the discount and Lombard rates	237
Reactions to securities repurchase transactions	242
5. The role of the Bundesbank in the liberalization of the financial markets	244
a) Liberalization: pro and contra	244
b) The actors involved in the liberalization process	245
c) The liberalization of the market for foreign D-mark debt securities	246
d) The Bundesbank's stance on new financial instruments	248
e) The Bundesbank's minimum reserve policy	250
f) The effects of the Bundesbank's policy on Germany as a financial centre	252
6. The Bundesbank's role in banking supervision	253
a) The reasons for supervising credit institutions	253

b) The allocation of banking supervision responsibilities	255
c) The regulation of lending and deposit rates	256
d) Deposit protection	258
e) Banking supervision beyond German borders	259
f) The dispute about 'liable capital'	260
7. The strengths and weaknesses of the German financial market	262
8. Sources and bibliography	265

Part Three

**MONETARY POLICY IN THE
FEDERAL REPUBLIC OF GERMANY**

VI. Monetary Stability: Threat and Proven Response. <i>By Manfred J. M. Neumann</i>	269
1. Guaranteeing the value of money as an essential prerequisite of a market economy	269
2. The purchasing power of the Deutsche Mark—an international comparison	270
a) The facts	270
b) Shifts in the price level as a problem for monetary policy	272
c) Price stability: a drag on growth?	274
3. Characteristic features of the German monetary constitution	275
a) The independence of the Bundesbank as an institution	276
b) Personal independence	278
4. Areas of conflict	280
a) Support for electoral interests	280
b) Selected cases of conflict	289
Adenauer's 'guillotine speech'	289
The foundation of the Franco-German Finance and Economic Council	292
5. Exchange-rate-policy considerations	294
a) The problem of underpinning the external economic position	295
b) The Bundesbank agrees to the setting-up of the European Monetary System	297
6. Strategic safeguarding by means of monetary targeting	299
7. Stability culture	303
8. Sources and bibliography	304

VII. Monetary Policy under Fixed Exchange Rates (1948-70).	
<i>By Carl-Ludwig Holtfrerich</i>	307
1. Initial hypothesis	307
2. A summary of economic and monetary trends	309
3. The institutions, goals, and instruments of monetary policy ..	317
4. Monetary and credit policy 1948-70	322
a) The 'weak D-mark' period: 1948-51	323
b) Monetary and fiscal policy mercantilism: 1951-6	341
c) Monetary policy on the horns of a dilemma: 1956-61	362
d) Monetary policy without massive external pressure: 1961-7	376
e) An attempt to resolve the dilemma: 1968-70	384
5. Conclusion	391
6. Sources and bibliography	397
VIII. A New Approach to Monetary Policy (1971-8).	
<i>By Jürgen von Hagen</i>	403
1. Introduction	403
2. Powerless in the face of disequilibrium: German monetary policy at the start of the 1970s	404
a) The German economy in disequilibrium	404
b) The Bundesbank's monetary concept	407
c) The monetary policy dilemma	408
3. Emancipation of monetary policy	411
a) A bulwark against imported inflation	411
b) Regaining money stock control	414
c) Experiences with open market policy	419
4. Monetary stabilization policy	421
a) Monetary policy, fiscal policy, and macroeconomic stabilization	421
b) Economic developments 1974-8	423
c) Monetary targeting	423
Steadying monetary policy	424
The first monetary target	424
'Limited steadiness' versus 'consistency with the situation'	426
Initial experiences with monetary targets	427
d) Predominance of counter-cyclical policy—end of the monetary targeting strategy?	428
e) The European Monetary System: saviour of monetary targeting	431
f) The policy of monetary targeting: an interpretation	433

5. Bibliography	436
IX. Monetary Policy under Conditions of Increasing Integration (1979-96). <i>By Ernst Baltensperger</i>	
1. Introduction	439
2. Monetary restriction: 1979-81	441
a) Point of departure and economic environment	441
b) The monetary policy of the Bundesbank in detail	444
Monetary targets and monetary growth	444
Steering the money market	446
Other monetary aggregates	448
c) Controversy over the appropriate degree of restriction	448
Orientation of monetary policy to the external position	449
Monetary target and monetary target variable	451
Target corridor	452
d) New forms of steering the money market	453
3. Relaxation and normalization of monetary policy: 1982-5	454
a) General trends and the monetary policy environment	454
b) The monetary policy of the Bundesbank in detail	456
Monetary targets and monetary trends	456
Money market steering measures and further development of open market policy instruments	458
Movement of other monetary aggregates	461
c) Public debate on monetary policy	462
d) Reorientation of monetary policy?	464
4. Monetary growth in excess of targets and slow return to restriction: 1986-9	465
a) General trends and the monetary policy environment	465
b) The monetary policy of the Bundesbank in detail	467
Monetary targets and actual monetary trends	467
Money market steering measures and additions to the range of instruments	470
c) Was monetary growth above the target corridor justified?	473
d) Change of monetary target variable	475
5. German monetary union: 1990-1	476
a) General trends and the monetary policy environment	476
b) The monetary policy of the Bundesbank in detail	478
Extension of the currency area and 'jump' in the money stock level	478
Monetary growth, monetary target, and money market steering	479

c)	Should the policy of monetary targets be retained in the face of the structural break caused by reunification?	482
d)	Public debate and international criticism	483
6.	The Bundesbank at the centre of international censure: gradual relaxation and monetary growth way above the target: 1992-4	484
a)	General trends and the monetary policy environment	484
b)	The monetary policy of the Bundesbank in detail	486
	Monetary targets and actual monetary trends	486
	Money market steering	489
	Modification of money market steering instruments	492
c)	Missed targets and 'special factors'	493
7.	Normalization of monetary growth and continued interest-rate cuts: 1995-6	495
a)	General trends and the monetary policy environment	495
b)	The monetary policy of the Bundesbank in detail	495
	Monetary target and monetary growth	495
	Money market steering measures	498
c)	Monetary policy in the public debate	500
d)	Monetary targets for 1997-8	500
8.	The Bundesbank's monetary policy strategy: do monetary targets make sense?	501
a)	A policy of monetary stabilization with discretionary elements	501
b)	Fundamental objections and alternatives	504
c)	Objections to the form of implementation	507
9.	The instruments deployed by the Bundesbank	509
a)	Open market operations	510
b)	Refinancing policy	511
c)	Minimum reserve policy	512
10.	The Bundesbank as role model?	513
a)	Strategy, current policy, and conflicting goals	514
b)	To what extent has the Bundesbank met its targets?	517
c)	The independence of the Bundesbank	518
11.	Sources and bibliography	521
X.	German Monetary Policy as Reflected in the Academic Debate. <i>By Rudolf Richter</i>	525
1.	1948-60: the economic miracle and Keynesian seductions	526
a)	The international debate, 1948-60	526
b)	The German discussion—basic themes and examples	527
	The debate on the goals of central bank policy	527
	The debate on the convertibility of the D-mark	530

	The opinion in the Bank deutscher Länder/Deutsche Bundesbank	532
2.	1961-72: Keynesianism, the exchange-rate debate, and the start of the monetarist counter-revolution	533
	a) The international debate, 1961-72	534
	b) The German discussion—basic themes and examples	536
	Safeguarding the currency under fixed or floating exchange rates: the exchange-rate debate in Germany in the 1960s . . .	537
	Monetary stabilization policy in the world of the neoclassical synthesis	538
	The advent of the monetarists	540
	The opinion in the Bundesbank 1961-72	541
3.	1973-84: monetarism under scrutiny: a new monetary policy, managed floating	542
	a) The international debate—a brief sketch	543
	b) The debate in Germany—basic themes and examples	544
	Monetary targeting versus liquidity policy	545
	Central bank intervention on the foreign-exchange markets: managed floating 1973-84	548
	The opinion in the Bundesbank 1973-84	550
4.	1985-96: monetarism goes, institutional economics comes—in small steps	551
	a) The international debate	552
	b) The debate in Germany—basic themes and examples	554
	Pro and contra monetary targeting by the Bundesbank	555
	Coordination of central bank intervention on the foreign-exchange markets	557
	The opinion in the Bundesbank 1985-96	559
5.	Conclusion	559
6.	Postscript	561
7.	Bibliography	562

Part Four

ASPECTS OF MONETARY POLICY IN THE TWO GERMANYS

XI.	The Central Bank and Money in the GDR. <i>By H. Jörg Thieme</i>	575
1.	Introduction	575
2.	Origins and development of the monetary system after 1945	576
	a) The restructuring of the banking system	576
	Nationalization and reconstruction (1945-8)	576

	Centralization of the banking system and establishment of a central bank (after 1948)	578
b)	The currency reform of 1948	580
	Political background, policy framework, and implementation	580
	Political and economic effects of the currency reform	584
3.	Money and credit in the GDR	587
a)	The role of money in the socialist planned economy	587
b)	Monetary planning and the central economic plan	590
	How the system worked	590
	Domestic economy	591
	Foreign economy	593
c)	Functions of the Staatsbank and the banking system	594
	Structure and political integration	594
	Tasks in the domestic economy	595
	The system of international payments	598
d)	Money supply and monetary targets	599
	The production of money in accounting terms	599
	Definitions of the money stock	600
	Targets and indicators of monetary policy	600
4.	Effects and functional problems of monetary control in the GDR	603
a)	Control of the money supply and inflation	603
	Measurement problems and empirical findings	603
	Causes of monetary mismanagement	606
	The effects of monetary stimuli	608
b)	Foreign trade, foreign debt, and currency reserves	611
5.	Monetary experiments in socialism: conclusions	613
6.	Key events in monetary policy	614
7.	Sources and bibliography	615
XII.	The Role of the Bundesbank in Intra-German Payments.	
	By <i>Jochen Plassmann</i>	619
1.	Introduction	619
2.	Interzonal payments following the division of Germany into occupation zones	620
3.	System of payments under the Allied foreign exchange control laws; responsibility and role of the Bank deutscher Länder and the Land Central Banks	622
4.	Clearing transactions and the 'swing' under the Berlin Agreement and the inter-bank agreements between the Deutsche Bundesbank and the Staatsbank der DDR	623

5.	Provision of tied and untied loans to the GDR; GDR debt owed to the Federal Republic	625
6.	Non-commercial payments with the GDR	627
	a) Legal basis for the Bundesbank's policy on authorization . .	627
	b) The Bundesbank's approach to authorization and its underlying objective	628
	c) Non-commercial payments not covered by government agreements	629
	d) Agreements of 25 April 1974 with the GDR on blocked funds and maintenance payments	630
	e) Travel payments	631
7.	Payments with the GDR in untied D-marks via 'free' accounts and foreign accounts authorized under foreign exchange rules; concealed transfers to purchase the freedom of prisoners	632
8.	Political and legal background to the role played by the Bundesbank in intra-German trade and payments	633
9.	Bibliography	638
XIII.	German Monetary Union. <i>By Manfred E. Streit</i>	639
1.	Introduction	639
2.	The currency reform of 1948: a historical parallel?	640
	a) Initial monetary conditions	640
	b) Initial conditions of the real economy	643
	c) Initial institutional conditions	645
3.	The monetary system to be transformed by monetary union	647
	a) Money and credit as instruments of economic planning . .	647
	The 'control via the Mark'	647
	The quality of the money	650
	b) Implications for the monetary transition	651
4.	Monetary union as part of a shock therapy	654
	a) Conditions for a monetary union	654
	b) Economics and politics of the monetary conversion	655
	Dubious grounds for the setting of the conversion rate . .	655
	Monetary and economic policy aspects of the conversion . .	656
	Political decisions and safeguarding the value of money . .	661
5.	The monetary transition	664
	a) Implementation of monetary union	665
	Currency conversion	665
	Establishment of means for refinancing	665
	Conversion of the banks' balance sheets	665

b)	Transformation of the banking system	667
	Institutional transformation	667
	Restructuring of the banking system	668
	Processing of the inherited debt	669
6.	Concluding assessment	674
a)	Responsibilities of the Bundesbank	674
b)	Responsibilities of the political decision makers	675
7.	Sources and bibliography	678

Part Five

THE INTERNATIONAL SCENE

XIV.	The International Role of the Deutsche Mark.	
	<i>By Jacob A. Frenkel and Morris Goldstein</i>	685
1.	Introduction	685
2.	Factors affecting international currency use	686
a)	Confidence in long-term value	686
b)	Open, deep, broad, and dynamic financial markets	687
c)	Economic size and political muscle	688
d)	Structure of foreign trade, choice of exchange arrangements, and currency-denomination of debt payments	689
e)	Optimal portfolio considerations	690
f)	Advantages of incumbency, and network effects among the functions of money	691
g)	Official attitudes, policies, practices to promote or discourage international currency use	692
3.	The D-mark as an international currency	693
a)	Relative inflation performance	693
b)	Behaviour of nominal, bilateral exchange rates	696
c)	Net creditor/debtor position	696
d)	Economic size	699
e)	Open, deep, and broad financial markets and official attitudes/practices toward international currency use	701
f)	Currency composition of official holdings of international reserves	707
g)	Private holdings of reserve currencies abroad	711
h)	Currency share of international assets	712
i)	Trading in foreign exchange markets	713
j)	Currency pegs	715
k)	Currency invoicing in international trade	716

4.	Other dimensions of the international role of the D-mark (and the Bundesbank)	719
5.	Concluding remarks	723
6.	Bibliography	725
XV. The Bundesbank and the Process of European Monetary Integration. <i>By Peter Bernholz</i>		
1.	The economic background	731
2.	The principal actors and their interests	733
3.	European monetary integration—initial scenario and approaches	737
4.	The period until the collapse of the Bretton Woods system	741
	a) Background and problems	741
	b) Developments up to 1964	742
	c) Developments 1964–73	746
5.	The EEC's Exchange Rate Mechanism	750
6.	The European Monetary System (EMS)	754
	a) Origins and features	754
	b) Further plans for the EMS	759
	c) The development of the EMS	760
7.	The plans for European Monetary Union	772
	a) The road to Maastricht	772
	b) The main provisions of the Maastricht Treaty on European Monetary Union (EMU)	776
	c) Further developments and prospects	779
8.	Summary of the major facets and features of monetary integration in Europe	785
	a) Record of the beginnings of integration, 1955–68	785
	b) Record of the EEC exchange rate arrangement, 1972–8	786
	c) Record of accessions to, and withdrawals from, the EMS . . .	787
9.	Sources and bibliography	788

ANNEX

List of Abbreviations	793
List of Tables and Figures	797
Index	801
The Authors	831