

### **Note on reform and prosperity in post-war West Germany**

In 1945 at the end of the WW II there was no nation on earth more devastated than West Germany. Ports, rivers and canals clogged with sunken ships, sunken barges, railways and communications devastated, six million of her most capable young men killed in battle, six million of her most productive people, the Jews, killed by

Hitler's henchmen. Heavy and light industry practically bombed out of existence, and 12 million refugees seeking a safe haven from socialism.

After three years of military occupation, inflation, controls and rationing, the ensuing chaos ruled supreme. At that time the Economics Minister, Ludwig Erhard, was a product of the Classical School. After serving in WW I he was trained as an economist by Walter Eucken, Franz Oppenheimer and Wilhelm Ropke. He knew that inflation and large state bureaucracies could not cure their problems. He knew that they were the problem.

Erhard was averse to everything authoritarian. Having carefully laid his plans, with agreement from the supervising Allies, he announced on June 19th 1948 that inflation was finished. A new currency would be issued. In round figures it was exchanged ten of the old marks for one of the new ones. The limit was 400 per person. 'And' said Erhard, 'there will be no more money printing'.

Then, knowing that he would never ever get agreement from the supervising Allies to change policy, he decided upon unilateral action. On Sunday July 8th, only three weeks later, he advised the public that he was to address the Nation between 11 pm and midnight about the problems which they faced and with which they were struggling. He advised them that in their own interest everybody should listen to what he had to say. He knew that ideology cannot be destroyed by force so he was persuasive.

He knew that everybody was sick of controls. He knew that everybody was sick and tired of being hobbled and kicked around by bureaucrats. He had also previously expressed his views in many speeches, and his speeches were always well reasoned. He was a master of his subject.

He announced to the population that he had, as from midnight that night, abolished all rationing, wage controls, price controls, government control and regulation of foreign exchange rates. He was also reducing taxation and heavily reducing tariffs. The burden of supporting tens of thousands of bureaucrats was, in one stroke, removed from the taxpayers shoulders. The following Tuesday (Monday was a holiday) Erhard was instantly called to book

by General Clay, the Commander of the resident US occupying force. Clay quickly came to the heart of the matter, 'Herr Erhard, my advisers tell me that what you have done is a terrible mistake. What do you say to that?' Erhard's reply came swiftly and without hesitation: 'Herr General, pay no attention to them, my own advisers tell me the same thing'.

Under the terms of the surrender no changes were to be made to Allied policy without consultation with the conquerors. An economist Army Colonel on Clay's staff shouted at Erhard, 'How dare you unilaterally relax our rationing system and price controls when there is a widespread food shortage!' Erhard replied courteously, 'But Herr Oberst, I have not relaxed rationing and price controls, I have abolished them'. It had not occurred to the bureaucrats that such a thing could possibly happen.

Erhard went on to say 'Henceforth, the only rationing ticket the people will need will be the deutschmark. And they will work hard to get these deutschmarks, just you wait and see'. He was confident, as reported in his book *Prosperity Through Competition*, and he abolished taxation on all income tax on hours worked over 40 hours.<sup>1</sup> A taxation policy which accumulated capital by the billion was '7-D' of the tax code. Under 7-D any German who invested in shipping and ship-building was granted a tax exemption. By 1953, 7-D had already attracted DM 1.5 billion out of the DM 2 billion invested in ship-building. Money came in from all over Germany. Another tax incentive which applied to all industries as well as ship-building was the remission of taxes on profits earned from export sales.

After giving the General a good sales talk about how successful his free market, low taxing programme was going to be, the ebullient, good natured Bavarian Professor departed from General Clay's office with the Military Governor's stamp of approval for his abrupt change of policy.

Under the glorious socialist rule of the Fuhrer and his Nationalist Socialist policies, Germans worked only 38 hours a week. Many uninformed people who marvel at the recovery wrought by

<sup>1</sup> See p. 19 of *Prosperity Through Competition*.

West Germany, attribute the recovery to the fact that 'The German people are great workers'. And so they are - but it is a curious anomaly that until the Berlin Wall fell in 1990, the process of recovery did not start in East Germany until 42 years later.

However to return to West Germany - immediately after Erhard's implementation of new policy, working hours commenced to voluntarily increase. Productivity increased dramatically as the people, free from the fetters of bureaucracy, and excessive taxation, went to work. Empty shop shelves filled almost overnight. With free labour markets, and free from Government Control and Regulation of Exchange Rates, the world's scarcest commodity, Capital, flowed like water into West Germany and together with a free people, went to work. Freed from excessive taxation, savings accumulated rapidly providing immense capital resources for the mighty engines of industrial production. An occupying witness later wrote 'Within a week, there was a new light of hope in the eyes of the German people'. A German who was there told me 'There was a new light in the eyes of the German people next day. We knew that if we were free of the bureaucrats we could really go to work'.

Erhard was constantly plagued to indulge in just a little government planning. His good natured riposte was 'You can no more have a little government planning than you can be a little bit pregnant'. By 1953 half a million homes were being privately built annually - and by 1957, that is in eight years, the Federal Republic had accumulated the largest gold reserves of any country in the world except the USA.

Erhard would not permit unbridled bureaucratic activity or money printing. Millions of German entrepreneurs emerged and went into business from barber shops to ship building. Foreign capital poured into Germany, bringing innovation, productivity and prosperity to the once destitute population. 'In order of importance, Germany has replaced the bureaucrat with the businessman' Erhard declared.

In five years, West Germany was producing more than all of Germany produced before the war. Not only that, unemployment

fell from 50 percent to 6 percent. In ten years not only was unemployment at zero, but it was necessary to import five million new workers from Greece, Turkey, Italy, Spain and France. Although opposition to all of Erhard's policies continued, the voices of the opposition were smothered by the success of his policies.

Detractors claim that it was Germany's share of Marshall Aid that brought on the recovery. But as reported by Henry Hazlitt '... Nothing similar happened in Great Britain, for example, which received more than twice as much Marshall aid. The German per capita gross national product, measured in constant prices, increased 64% between 1950 and 1958, whereas the per capita increase in Great Britain, similarly measured, rose only 15%'.

Erhard reported in his book *Prosperity through Competition* that hordes of businessmen constantly called at his office seeking and even demanding privileges. Tariff protection and subsidies were their favourite subjects. Although he was pressured by many powerful industries, he did not capitulate to their demands. He replied that they had an ample, intelligent labour force willing to work hard, they had technical skills equal to any anywhere, his good policies attracted capital and the people were saving new capital, and under a regime of secure property rights, honest money, no protection or privileges, competition on a national and international scale produced strong industries. In turn, strong competitive industries were best placed to capture world markets. And strong competitive industries were the best insurance the nation had to keep her people employed and to provide constantly rising living standards. The success of his philosophy is now history. After Erhard's reform, Germany had Europe's strongest and, one of the world's strongest currencies, until the establishment of the Euro.

It boasted one of the world's highest living standards. The Bundesbank was Europe's strongest bank and the deutschmark the currency against which all other European currencies were measured. And this was the case for many years. In Erhard's book *Prosperity Though Competition* he titled Chapter 12 'Welfare State - The Modern Delusion'. In 12 pages he warned the West Germans to

avoid the welfare state, as, if implemented, it would bring economic and social disaster. Unfortunately vote seeking politicians did not listen to his wise words and now Germany is paying the price. The present Chancellor now realises the deadly fix the country is in and he has established a two thousand strong bureaucracy to study where cuts can be made. Not only is Germany in peril, but all of the European states.

In France we have read that Frenchmen are forbidden to work more than 35 hours a week and state inspectors, with the power to inflict on the spot fines, frequently visit to see that this ridiculous edict is adhered to. But that cannot last.

A friend of mine, a young Australian civil engineer who recently migrated from Hong Kong (after over ten years there), to England with his wife and young family, wrote to me saying

The level of violence and the general attitude of the UK population scare me. They all seem to think that the government can endlessly provide for them and not do any work. I recently found out that a family on benefits (admittedly with 8 kids) 'earns' more on benefits, than I do for working full time and I was disgusted. The father was just a lay-about. There seems to be no cure for the ills of the world. Last week a 14 year old stabbed another 14 year old to death at school. Things like that just don't happen in Asia!

As stated above, he had been in Hong Kong for over 10 years and had played a major role in the erection of buildings all over Asia including the world's tallest building in China. He is very familiar with most of Asia and Australia.

### **Note on reform and prosperity in post-war devastated Japan**

After the war, in the early 50's, Japan's economy was about half the size of what Australia's was then. In spite of Japan's pre-war and wartime totalitarian experience, there was quite a strong classical liberal tradition in Japan, led by the late Nobutane Kiuchi. And, one of Japan's great classical liberal activists was the then leader of Japan's Ministry of International Trade and Industry. His name was Tanzan Ishibashi.

As reported by George Gilder in his book *Recapturing the Spirit of Enterprise* (ICS Press, San Francisco, USA.), the Japanese people were very heavily taxed at that time. Eschewing US advice to raise taxes, and employ Government ‘initiatives’, he insisted that the key to reviving the domestic market and ending the post Korean war recession was not a siege of administrative guidance and fiscal austerity but a series of whopping tax cuts. Gilder reports:

He focused on personal income and savings. His first tax cut was accompanied by abolishing the tax on the interest of savings. He then cut the tax rate on dividends from 11% to 7% and as well cut personal rates by 10%. Corporate tax was dropped from 42% to 40%. As a result, curiously, the total tax revenues rose by 15% and (voluntary) savings rose to an astonishing 31.5% of personal income.

It was in 1956 that Ishibashi became Prime Minister himself, promising even more tax cuts on personal incomes. While launching new efforts in public works he slashed personal income tax rates by nearly 30% across the board. In a fortunate decision he placed another classical liberal oriented scholar, Hayato Ikeda, in charge of the Ministry for Finance. This ensured the relatively long term future of his programme.

On top of the personal income tax cuts and the abolition of interest on savings, he tripled the amount that people could deposit in the now famous postal savings accounts. He doubled the deductions for life insurance and issued a government bond upon which the interest was tax free. Capital gains tax was non-existent. On top of that, long term savings, which we call superannuation, was made directly deductible and tax free.

He had the courage to back his conviction and demonstrated in a practical, no holds barred manner, the effectiveness and popularity of an all out attack on the conventional wisdom of heavy taxation. Because of the soundness of his example, these policies endured for 20 years after his death. Savings and revenue increased with every tax cut, and innovation and productivity soared, as he predicted.

The fact is, with secure property rights, honest money, and when taxes are low and savings are high, the governments tax take although relatively low, is adequate to service the legitimate activities of government, without the government resorting to loans and

inflation. Then interest rates fall, thus facilitating even more entrepreneurial activity, as capital flows from investing in government bonds into the increasingly profitable, less taxed, industries of production and exchange.

Until 1990 the once economically crippled Japan was second only to the United States of America as a productive colossus. Unfortunately a spate of Keynesian/socialist induced inflation in the early 1980's has slowed Japan and has caused serious problems. It has in fact, devastated much of the financial community, both in Japan and overseas. Japan has not yet demonstrated the sort of policies which will engage in the process of recovering from such indiscreet activity, the inflation induced trouble is far from over.

### **Notes on reform and prosperity in post-war Taiwan**

Taiwan has an area of only 36,179 square kilometres (13,965 square miles), or about half the size of Tasmania, but has virtually no natural resources. Yet between 1952 and 1986, with a population of only 8.13 million it achieved a seven fold increase in real per capita income, while at the same time, increasing its population to 19.46 million. This amazing record is all the more remarkable due to the grim fact that the island nation has had to maintain a constant state of military preparedness.

In summer of 1954, Taiwanese nationals, and Classical Liberal scholars, the late Prof. Liu and the late Prof. S.C. Tsiang were called upon to advise the then totalitarian government on economic policy. The government had doubts as to the validity of Liu's and Tsiang's 'radical' advice. Consequently Liu and Tsiang recommended that they take a large party of the relevant officials to Germany, to study what Ludwig Erhard had accomplished with an honest money, low tariff, small taxing, non interfering government, coupled with a free market economy.

The officials, although very impressed with Germany's turn around and success, voiced their doubts as to where the entrepreneurs would come from and what they would do, and who would do



their planning. 'Don't you worry about that' Prof. Tsiang said, 'every society has its entrepreneurs if they are given the opportunity. We must ensure that good policy encourages that opportunity. As for planning, the free market automatically co-ordinates the individual planning of all of the active entrepreneurs and their consumers - just you wait and see.' Then, as for 'what they would do' Professor Tsiang replied that again 'there is no need for bureaucrats to be concerned with what economic activity entrepreneurs engaged, as they would engage in and produce products heretofore unthought of in Taiwan' - which was subsequently the case. At a meeting of economists, social scientists and intellectuals in Tokyo and Kyoto in 1988, which this author attended, Professor Tsiang said that ultimately even Liu and he were surprised at the magnitude of Taiwan's success.

By 1970 the (US) dollar value of Taiwan's exports had increased from \$93 million in 1954 to \$1,481 million. That represented an increase of 15.93 times that of 1954 in 16 years. By 1980 the dollar value of Taiwan's exports reached \$19,811 million, more than 200 times that of 1954.

Foreign investors were welcome, often bringing new ideas and new marketing strategies with the new capital. Although agricultural production increased dramatically, by 1970 its share of G.N.P. declined to 15.5% while that of industrial output had climbed to 41.3%, services being 42.4%. By 1985 increased agricultural output was down to only 6% while the share of industrial products rose to 49.7%, services being 44.3%.

Exempting from personal income tax the interest on savings and time deposits with maturity terms of two years or more, and, exempting from corporate income tax profits which were ploughed back into investment, resulted in an inflow of voluntary savings into the banking system. The resulting investment in new technology was high productivity per worker. For instance, Taiwan is now the world's leading personal computer technology manufacturer. (See *The Australian* 10.10.95). From a country where people would not save at all, Taiwan became a country with a very high propensity to

save. Since 1972, Taiwan's percentage of national income saved surpassed that of Japan, (as high as 35.2%). Taiwan in year 1995, had the world's highest foreign exchange savings. They later accrued to over \$100 billion (US) then later accrued to over (US) \$300 billion. All of this incredible achievement from a population approximately the same as Australia, living in an area less than half the size of Tasmania.

It should be noted that Germany, and three of the five other success stories, Japan, Taiwan, South Korea had previously been totalitarian nations. The totalitarian nature of their previous administrations had dragged their people into the most destructive wars in all of history. The wars had ultimately dragged the people into the gutter of humanity, but Classical Liberal policy had led them out to unprecedented prosperity. And their totalitarian character has been peacefully and successfully replaced by democracy.

Please keep uppermost in your mind, the essential point to note is that it is at all times everywhere that the institution of secure private property, free markets, honest money, rule of law and low taxation, makes a people and its inhabitants comparatively prosperous. It is the free market that slowly but surely develops the genuinely egalitarian society. Having achieved this, social planners start meddling, overtaxing and intervening in order to bring about their notions of 'equality'. Countless examples show that this in turn destroys free prosperous societies and brings about totalitarianism. If freedom and prosperity is what we seek we must stick to the rules. And as we are discussing rules, it is well to remember the wise words from Exodus 20-17:

Thou shalt not covet thy neighbour's house, thou shalt not covet thy neighbour's wife, nor his manservant, nor his maid servant, nor his ox, nor his ass, nor anything that is thy neighbour's.

Our persistent departure from these rules is the source of many of our problems.