The Central Bank Council fifty years ago

Fifty years ago, on March 1, 1948, the Bank deutscher Länder (the predecessor of the Deutsche Bundesbank, which was established in 1957) was brought into being by Allied military legislation. The US authorities contributed the decentralised composition of the Central Bank Council as well as, in large part, the Council's independence from instructions from German agencies, while the British authorities contributed the Bank deutscher Länder's status as a note-issuing central institution. German efforts supplemented that system – partly in later years – by adding, in particular, a number of centralist elements and features fostering co-operation with the central government.

The present article[1] analyses some major aspects of the debate on the constitution of the Central Bank Council, and concludes by addressing the question of the capacity of the central banking system to function in its first few years. The key question in all the debates held at that time, which were often marked by disagreements, was – following the discrediting of the Reichsbank under the Third Reich – how the new German central bank should be designed so as to enable it swiftly to rebuild confidence in its counter-inflationary stance both at home and abroad.

1 The analysis is based on records of the Land Central Banks, the Reichsbank Head Office, Hamburg, and the Bank deutscher Länder in the Historical Archive of the Deutsche Bundesbank, of the US military government (micro-films) and the Money and Credit Special Agency in the Federal Archive at Koblenz and of the Archives de l'Occupation françaises in Colmar.

The first few months – a number of facts and questions

Establishment of the Bank deutscher Länder on March 1, 1948

On March 1, 1948, the Bank deutscher Länder was set up, under laws passed by the US and British military governments, as the Head Office of the Land Central Banks of both zones of occupation. On March 8, the Central Bank Council of the Bank deutscher Länder convened for the first time. The Land Central Banks of the French zone acceded to the system at the end of March 1948. Thus the first trizonal, all-west-German institution after the war was born. In 1957 the Bank deutscher Länder, after amalgamation with the Land Central Banks, was transformed into the Deutsche Bundesbank by the Act approved by the Deutscher Bundestag on July 26, 1957.

During the first three months, Central Bank Council meetings were dominated by debates on the constitution of the new central banking system, rather than by discussions of monetary policy.

No monetary policy before the currency reform

Prior to the currency reform, there was no possibility of influencing the money stock or the price level by means of monetary policy. The establishment of the Bank deutscher Länder did not change that situation. The monetary overhang deriving from the financing of armaments and the war effort under the Third Reich (in 1947-8 the ratio of the money stock to GNP was ten times as high as that in "normal" times) and the low level of output due mainly to price-fixing and production controls resulted in only a sluggish demand for credit from banks and central banks. The total amount of bank lending to the private sector had stagnated since 1945 and was largely unresponsive to changes in interest rates. The discount and lombard rates were therefore kept at the levels fixed in 1940. An internal memo by the Reichsbank Head Office, Hamburg, dated May 1948, said: "The restructuring of our central banking system cannot exert any monetary policy impact as long as the monetary overhang and undue economic controls make an effective monetary policy quite impossible. Only after the currency reform will the decentralised central banking system have to face the acid test."

The constitutional problems at the time the Bank deutscher Länder was set up…

On the other hand, the constitutional debates of the first few years provide points of departure for a look back at the Central Bank Council 50 years ago. The west German central banking system set up in March 1948 was a compromise between US and British thinking, in which some German ideas were also incorporated. Unlike the Reichsbank, whose successor it became in function, although not in law, the new system was structured in a two-tier, highly decentralised fashion: it was two-tier insofar as the Land Central Banks were owned by the Länder and, in their turn, held the capital of the Bank deutscher Länder; the Land Central Banks obtained funds to finance their business from the Bank deutscher Länder and held minimum reserves at that Bank.

The composition of the supreme decision-making body was decentralised. The Central Bank Council comprised its Chairman, the President of the Directorate (in those days called the "Board of Managers") and the (at that time eleven) Presidents of the Land Central Banks. The Land Central Bank Presidents, appointed by the Prime Ministers of the Länder, elected the Chairman of the Central Bank Council and the President of the Board of Managers. The entire Central Bank Council elected the other members of the Board of Managers, who, however, were not at that time members of the Central Bank Council. The Central Bank Council was entitled to issue monetary policy instructions to the Land Central Banks and the Board of Managers of the Bank deutscher Länder (as its executive arms). In its monetary policy decisions, it was independent of instructions from German bodies but, until 1951, it was subject to instructions from the Allied Bank Commission, on which the financial departments of the three military governments were represented.

At the time of the establishment of the Bank deutscher Länder on March 1, 1948, the Central Bank Council had not yet been "constituted" and was not fully able to work. Not only were the Presidents of the Land Central Banks in the British zone (which Banks had only just been set up) lacking and had the Board of Managers to be made able to work by the election of Departmental Heads; above all, the Chairman of the Central Bank Council and the President of the Board of Managers still had to be elected. That was not done until May 20, 1948. The Central Bank Council first met at full strength on June 1, 1948.

The election of the President kept the Central Bank Council on tenterhooks for two months. France attached so much importance to influencing that election that it speeded up the accession of its zone of occupation to the central banking system. The election once again reflected some controversial issues which had already played a part when the system was being set up. After prolonged negotiations, the Allies finally rejected both Otto Schniewind and Hermann Josef Abs (both bankers), who had been nominated by the Central Bank Council for the posts of Chairman of the Central Bank Council and President of the Board of Managers, respectively. They agreed only to the subsequent proposal by the Central Bank Council, viz. to elect Karl Bernard (likewise a banker) as Chairman of the Central Bank Council and Wilhelm Vocke (until 1939 a member of the Reichsbank Directorate and since 1946 Deputy Chairman of the Board of the Reichsbank Head Office, Hamburg) as President of the Board of Managers.

... resemble those nowadays facing the European System of Central Banks

Some of the constitutional problems confronting the west German Central Bank Council resemble those nowadays facing the European System of Central Banks. Today, as at that time, the important matters are, for instance, the safeguarding of a stability-oriented monetary policy on the part of a decision-making body composed in principle along decentralised lines, the underlying institutional conditions, and the selection of suitable senior executives. Today, like then, the overriding question is how an untried central bank should be equipped in institutional, personal (and instrumental) terms in order swiftly to gain the confidence of residents and non-residents alike in its anti-inflation policy.

Which Allied and German standpoints conflicted with one another in the institutional and personal debates, and which standpoints came to be accepted – over the longer term as well? And to what extent did the fears associated in particular with the decentralised composition and two-tier structure of the system, and with the Allies' right to issue instructions, turn out to be warranted in the first few years?

How decentralised may, and how centralised must, a central bank be structured?

The west German central banking system – a compromise between the Allies

This question was debated instructively in several respects, and (in part) at length, between the Allies and the Germans, and within both sides. At major points, the Americans were guided by their own national central bank structure. Moreover, they hoped quite generally that, by splitting up centralised German institutions, they could avert the risk of a repetition of the Third Reich. The French shared these political considerations. The British, by contrast, believed that only a central bank with a centralised structure, like the Bank of England or the Reichsbank, would work properly.

In the immediate post-war years, the Allies organised the central banking systems in their zones along correspondingly decentralised or centralised lines: in the Länder of their zones of occupation, the Americans and French set up independent Land Central Banks. Uniform Land Central Bank decisions were to be ensured in the French zone by a Coordinating Committee entitled to issue instructions, and in the US zone by a Banking Council confined to recommendations. In their zone, the British retained the organisation of the Reichsbank, and placed a single "Reichsbank Head Office" (in Hamburg) at its head.

In the individual zones, the German views on the question of an all-(west)-German central bank structure resembled those of the respective occupying power, but without actually coinciding with them. Although no German Parliament voted at the time on the structure of the future central bank, two groups of experts representing a broad range of opinions discussed the Act Establishing the Bank deutscher Länder beforehand at some length: the Money and Credit Special Agency (in Bad Homburg) attached to the financial administration, and chaired by Ludwig Erhard; and the Commission of Experts "Länder Union Bank" attached to the monetary committee of the bizonal Economic Council. "Centralists" and "decentralists" alike were represented in both bodies: in the Special Agency, for example, Erwin Hielscher, the Munich City Treasurer, was a centralist, and Otto Pfleiderer, the later Land Central Bank President of Württemberg-Baden, was a decentralist; in the Commission of Experts, Wilhelm Vocke was a centralist and Max Grasmann, the Land Central Bank President of Bavaria, a decentralist.

In both bodies, a majority believed that they could live with most features of the new central bank structure. But they massively criticised its dependence on instructions from the Allied Bank Commission and its organisational structure. In particular, the centralists in both bodies – and the decentralists, too, albeit with differences of degree – thought the composition of the Central Bank Council was much too decentralised.

Three aspects of the debate at the time deserve attention:

1. The operationally active central bank

Some of the duties originally intended for the Bank deutscher Länder posed problems

Ultimately, the Allies and the Germans jointly advocated the establishment of the Bank deutscher Länder as a central bank that was also operationally active (e.g. in international business, or as the "fiscal agent" of the government). The resultant specific "mix" of centrality and decentrality gave rise to tensions in the implementation of monetary policy.

Control by means of the two-tier structure...

An example of such tensions is an expectation that was originally associated with the two-tier structure of the central banking system. As stated above, the Land Central Banks obtained funds to finance their operations from the Bank deutscher Länder and held minimum reserves at that Bank. It was believed that the Bank deutscher Länder could influence lending by the Land Central Banks by changing the internal refinancing rates and minimum reserve ratios. That belief was mistaken. The Central Bank Council influenced lending by the Land Central Banks only by setting the discount and lombard rates and minimum reserve ratios for the banks taking up the credit and other guidelines for the external relations of the Land Central Banks. The Land Central Banks' recourse to the Bank deutscher Länder was an automatic operation whereby the Land Central Banks raised the credit they needed regardless of their actual liquidity position. The Land Central Banks' need for funds to finance their operations was merely a reflection of the monetary policy pursued by the Central Bank Council. The internal refinancing rates and internal minimum reserve ratios only affected the distribution of profits between the Bank deutscher Länder and the Land Central Banks.

... and the excessive granting of private-sector-credit and lender-of-last-resort facilities

Moreover, problems were posed by the idea likewise advocated by the British authorities and the Reichsbank Head Office, Hamburg, that a strong, operationally active central bank is necessary to be able to bear the credit risks emanating from regional and sectoral structural assistance. Behind this notion was the circumstance that the Reichsbank Head Office had granted sizeable stand-by credits at the preferential rate of 2 % (instead of the normal discount rate of 3½ %). The recipients of those loans were the low-earning North Rhine-Westphalian coal and steel industry and north German credit institutions, which were at risk of becoming illiquid owing to blocked claims on the German Reich and withdrawals of savings balances. That was expected to persist at the all-(west)-German level. The Americans objected that the central bank was not responsible for long-term loans to banks in difficulties; it should refrain from inflationary lending. And even Wilhelm Vocke, despite feeling every sympathy for a strong central bank head office, conceded that large-scale stand-by and financial credits were in fact the last thing that a central bank should grant.

Ultimately, the Allied legislators defused the conflict situation that may arise for the central bank if, on the one hand, it is supposed to safeguard monetary stability but, on the other, it is required to provide excessive private-sector-credit and lender-of-last-resort facilities. To finance economic reconstruction, a special institution, the Kreditanstalt für Wiederaufbau (Reconstruction Loan Corporation), was set up. As part of the currency reform, credit institutions were protected from illiquidity due to the reform by being allocated interest-bearing equalisation claims on the public sector to square their balance sheets, in place of the deleted claims on the German Reich.

2. The right to issue instructions to the Land Central Banks

The Central Bank Council – unlike the Banking Council in the US zone – was empowered to issue instructions

It was finally agreed by all those concerned that the Central Bank Council should have a right to issue instructions, rather than merely a right to make recommendations, vis-à-vis the Land Central Banks that actually implemented its monetary policy decisions. In the absence of gold cover, as Wilhelm Vocke emphasised in January 1948, "a tight uniform pursuit of central bank policy is to be regarded as the sole guarantee of the new currency". And, at the same time, in the Money and Credit Special Agency, Ludwig Erhard explicitly advocated a federalist central banking system with a Board whose instructions left "no room for manœuvre at all for the Land Central Banks".

The topic kept on recurring because it was thought that the requirement of uniformity laid down in the Land Central Bank Acts of the US zone (which were German cabinet laws) was being violated: under the legislation, the Land Central Banks were only supposed to comply with the recommendations of the Banking Council, encompassing the entire zone, i.e. they were not required to conform to any instructions issued by that body. The Land Ministers of Finance, to whose supervision (albeit not to whose instructions) the Land Central Banks were subject, were anxious not to allow any doubts to arise as to the "recommendation" status of the Banking Council's decisions. This weakness in the structure of the Banking Council may in practice have failed to generate tensions only because no far-reaching monetary policy decisions had to be taken before the currency reform.

3. The composition of the Central Bank Council

German wishes for a more centralised composition of the Central Bank Council were fulfilled only in part or only at a later date

By contrast, the debate on the composition of the monetary policy decision-making body was marked by controversy right up to the end. With the possible exception of a number of south German representatives, the German experts were strongly opposed to filling the vacancies on the Central Bank Council exclusively with Land Central Bank Presidents. The radical counter-position was adopted by the Reichsbank Head Office, Hamburg. As in the old Reichsbank, reflected in the Dawes Plan of 1924, the Board of Managers of the Bank deutscher Länder should take the monetary policy decisions, in the Head Office's view; a General Council should merely have the task of appointing the Board of Managers and debating monetary policy. Slightly less centralist in orientation was the demand backed by a sizeable group that the Central Bank Council should be supplemented by a range of persons nominated by the parliament of the bizone, the Economic Council.

The lowest common denominator on which all the German experts assembled at the end of January 1948, finally managed to agree was the proposal (based on the structure of the Banking Council in the US zone) to enlarge the Central Bank Council: the Land Central Bank Presidents should be supplemented by an equal number of persons drawn from trade and industry, farming, banking and the ranks of employees; the Land Central Bank Presidents should elect this group of persons to join them.

But this proposal likewise found no favour among the Allied military legislators, which prompted the Commission of Experts to protest against the entire Act. On the other hand, German efforts to bring about a more centralist composition of the Central Bank Council were successful insofar as it was enlarged to include two members elected for three years each: a Chairman, who was not at the same time to be a Land Central Bank President, and the President of the Board of Managers. More far-reaching ideas elaborated in 1948 among the Commission of Experts did not find general acceptance until 1957, in the Bundesbank Act: the members of the Directorate nominated by the Federal Cabinet received a seat and a vote on the Central Bank Council.

The Americans (and the French) regarded a Central Bank Council composed solely of Land Central Bank Presidents as an effective instrument for decentralising economic power. By contrast, the German opponents of a wholly decentralised composition stressed that Land Central Bank Presidents would represent Land interests unduly, and that an aggregation of Land interests would not generate the tough monetary policy that was necessary in the national interest. The Land Central Bank Presidents would be able to push Land interests through, it was argued, above all because they themselves decided the rediscount rates and minimum reserve ratios imposed on them; the Central Bank's policy-making body was made up of representatives of the debtors.

A crucial issue in Germany: lending to the public sector

Statutory basis of the limitation of lending to the public sector: German wishes meet with qualified success

Besides the more centralist composition of the decision-making body, the restriction of central bank lending to the public sector at the end of January 1948 was the second major request of the German side to the architects of the US/British draft Act Establishing the Bank deutscher Länder. And that request met with success. The empirical background to the request was the two hyperinflations Germany has experienced during this century, which were due mainly to the financing of most government expenditure by the central bank. At the beginning of February 1948, the Commission of Experts "Länder Union Bank" highlighted the following point as a problem facing even an independent central bank: "Unless statutory barriers are erected against unrestricted recourse to the central bank (barriers to which that bank can draw attention), in the long run it will be difficult for the central bank to deny the public sector's pressing, repeated and perhaps even fiscally not unwarranted requests for credit, if they are backed by public opinion, even when they assume alarming proportions in monetary terms." The Commission proposed a quantitative limitation of short-term lending by the Bank deutscher Länder to the central government, which the Central Bank Council would be empowered to increase up to a certain ceiling, but only by a majority of three-quarters. The Allies incorporated this proposal in the Act.

How much importance the Central Bank Council attached to the curtailment of central bank lending to the government (for the sake of preventing inflation) was shown by the tension generated by the election of the senior executives of the bank in April/May 1948. With regard to lending to the government – not, however, with respect to general monetary policy – the Land Central Bank Presidents were ready and willing to make a special commitment in order to safeguard monetary stability, thus, in a sense, depriving themselves of power: on April 2, 1948 the Land Central Bank Presidents elected the bankers Otto Schniewind and Hermann Josef Abs Chairman of the Central Bank Council and President of the Board of Managers, respectively. Both Schniewind and Abs criticised the domination of the Central Bank Council by the "debtors", and made their consent dependent on being granted a joint veto right over decisions by the Central Bank Council. The Land Central Bank Presidents refused. Schniewind and Abs then narrowed down their demand to the point that really mattered to them: direct and indirect lending by the bank to the public sector was to be possible against the votes of the Chairman and Deputy Chairman (i.e. the President of the Board of Managers) only by a three-quarters majority of the Central Bank Council. The Land Central Bank Presidents agreed to this demand, and applied to the military governments for a corresponding amendment of the Act. The Allied Bank Commission rejected that application on grounds of principle. Moreover, it raised objections to the persons of the two candidates, who were not elected for that reason.

The independence of the central bank – an imposition on the part of the Allies?

The German position: an independent central bank ...

Besides the decentralised structure, the independence of the Central Bank Council from instructions from German government agencies was a major feature of the Allied military legislation governing the establishment of the Bank deutscher Länder. That provision, which was in line with the regulations for the Reichsbank between 1922 and 1937, generally met with approval on the German side; at all events, it cannot be said that it was imposed contrary to German wishes. Admittedly, during the deliberations on the Land Central Bank Acts for the US zone of occupation in 1946, the joint mouthpiece of the Länder Governments, the Länder Council, had come out strongly (but unsuccessfully) in favour of making the Land Central Banks subject to instructions from the Land Ministries of Finance. But the deliberations of the bizonal Commissions of Experts on the Bank deutscher Länder Act in January and February 1948 do not suggest that those bodies rejected the idea of a central bank independent of instructions.

With respect to that Act, the Commission of Experts "Länder Union Bank" only raised the (vain) objection that the Central Bank Council should likewise be exempt from instructions from the Allied Bank Commission. In the Money and Credit Special Agency, the advocates of a central bank subject to instructions – primarily Günter Keiser and Hans Möller (in contrast, for instance, to the Chairman Ludwig Erhard, who was in favour of an independent central bank) – were in the minority. The reasoning behind these positions is also instructive as regards their representativeness. Keiser and Möller wanted the economic and financial administration to have the right to issue instructions so as to be able to use monetary policy as an instrument of economic management. As Otto Pfleiderer, the later President of the Land Central Bank of Württemberg-Baden, put it at the meeting of the Special Agency on January 20, 1948: "As long as Dr Keiser and Dr Möller conduct our economic policy, I do indeed believe that we are exceptionally dependent on the monetary side. In reality, our entire output is decided by Dr Möller, and our credit volume only has to adjust to the volume of output, which is determined elsewhere." Erhard told the social democrat Keiser that, in a free market economy, it is no longer necessary for the economic administration to have any say in monetary policy. That comment on the issue of the independence of the central bank was apparently a reflection of the regulatory position. In the bizonal Economic Council, the advocates of a free market system were in the majority in June 1948, as the favourable vote on Erhard's Guiding-Principle Act shows.

The special feature of the German majority view was that it regarded both freedom from instructions and cooperation with the central government as necessary. That linkage was to become the distinguishing token of the German central bank constitution and central bank policies in the subsequent decades.

... that cooperates with the government

The debates of the Special Agency are permeated by the idea that central bank policy cannot seal itself off from real economic problems; the high level of unemployment in the early thirties was in everyone's minds. "I think it is quite out of the question," Ludwig Erhard told the Money and Credit Special Agency on January 20, 1948, "if the unemployment figures go up yet again, for the central bank to mount its high horse once more and exhibit indifference. That is of course out. The last word will certainly always be spoken by the politicians, but an institution which actually is there only in order to protect the currency must be given a large measure of independence." That was a profession of faith in constant coordination, rather than in a central bank subject to instructions. When, at the meeting on January 10, 1948 Erwin Hielscher raised the question of whether the Economic Council should have a right to give instructions to the central bank, Günter Keiser said "Yes" and Ludwig Erhard "No".

In the Commission of Experts "Länder Union Bank" the principal argument against the Allied Bank Commission's right to issue instructions was that it made impossible the requisite constant "coordination of central bank policies and economic policies", i.e. cooperation between the responsible German institutions. Cooperation with the Federal Cabinet remained an object of the central bank. Vocke, that vigorous champion of an independent central bank, as President of the Board of Managers, offered Federal Chancellor Adenauer at the end of October 1949 – on the basis of a proposal first made as early as 1947 – to set up an interministerial committee to which he would report regularly on the monetary and financial situation.

The German Transference Act of August 10, 1951, which released the Bank deutscher Länder from the Allied Bank Commission's right to issue instructions, without substituting any right to issue instructions on the part of German institutions, gave due account to these considerations. The Federal Cabinet was granted a right to attend meetings of the Central Bank Council and a postponing veto right to defer Central Bank Council decisions; at the same time, the central bank was required to support the government's general economic policy, without prejudice to the performance of its duties. The Bundesbank Act (1957) took over those provisions, in slightly modified form. In the military government Act Establishing the Bank deutscher Länder, any such commitment to cooperation was lacking; the Allies evidently considered any form of agreement between the central bank and the central government to be incompatible with the independence of the central bank.

The idea of a "Currency Office": a body for creating underlying regulatory conditions for the currency reform

By setting up an additional "Currency Office", the experts of the Money and Credit Special Agency explicitly did not intend to curb the powers of the Central Bank Council. The Office was meant to be established alongside, but not over, the Bank deutscher Länder. The duties and powers of the Bank were not supposed to be affected by the establishment of the Office. The plan deserves attention because it reflects a clear recognition that the currency reform and monetary policy could be conducted successfully only with the aid of additional measures from other policy areas. The Office was intended to initiate those political steps towards safeguarding the currency which were outside the province of the central bank, e.g. measures to lift the price and wage freeze and the controls on production, and moves to reform the tax system and balance the budget. It was intended to ensure that the policies of all relevant government departments were geared to protecting the currency. To that end, the directorate of the Currency Office was to be advised by a body composed of representatives of the various ministries and the Chairman of the Central Bank Council, and was to be entitled to request appropriate emergency ordinances from the head of the central government.

The Allies rejected this proposal, apparently because the distribution and definition of responsibilities were too imprecise. All that happened was that a currency division, which was supposed to prepare supplementary instructions for the Central Bank Council and the Allied Bank Commission on the implementation of the currency reform, was set up at the Bank deutscher Länder. The original key task of the Currency Office, namely the non-monetary regulatory safeguarding of the currency reform, was meanwhile taken over by Ludwig Erhard, after he had become the director of the economic administration. He had himself empowered by the Act of June 24, 1948, (the "Act on Guiding Principles for Economic Management and Price Policy") to abolish price-fixing and production controls.

Trustworthiness – also a matter of the persons involved

Heated debate on the criteria of trustworthiness:

"Since, in the absence of precious metal cover, the monetary policy of the Bank deutscher Länder will be the real and only guarantee of the viability of the future currency, it goes without saying that only men of proven ability in the fields of monetary and central bank policy can be considered for posts on the Board of Managers [what is meant is the monetary policy decision-making body]. The confidence of residents and non-residents is, after all, the most important asset the bank requires." This remark by the Reichsbank Head Office, Hamburg, (Monthly Report of January 1948) reflected the general opinion that the central bank and the currency could win confidence only if suitable senior executives could be found. There were, however, some highly divergent views on the aptitude criteria.

decentralised appointment,

German critics objected that Land Central Bank Presidents would take their monetary policy decisions in the light of Land, rather than national, considerations; they might well lack the due insight into the situation, the requisite toughness of action, and the courage to take unpopular decisions. The Land Central Bank Presidents, for their part, questioned whether a sense of responsibility and objectivity depended on centralised or decentralised appointment, and emphasised that they were in no way representatives of the Länder, but rather independent agents.

experience of banking

The Americans – unlike the British – did not regard professional qualifications alone as being decisive. From the outset, they had a preference for Land Central Bank Presidents as monetary policy decision-makers "for democratic reasons"; they hoped thus to prevent the centralisation of political and economic power. In addition, they believed that using experience of banking as a selection criterion would reward only those who had gained experience of central banking under the Third Reich. Finally, the Allies took due account of denazification considerations. They decided (the French with particular enthusiasm) to bar from the top positions not only those who had been associated with the Nazis more closely than merely as fellow-travellers, but also those, for example, who had played a special role in the economy of the Third Reich.

Criticism of the criterion "experience of central banking" was also voiced by German commentators. That criticism related, however, not to the Third Reich, but to the "orthodox monetary policy" pursued by the independent Reichsbank during the Weimar Republic. For instance, in the eyes of Otto Pfleiderer, who suggested Karl Bernard as a possible chairman of the Central Bank Council and who also exercised some influence on the composition of the Board of Managers, the Reichsbank had failed both in the inflation of 1923 and in the Great Depression from 1930 to 1932.

The composition of the Central Bank Council in the first few months

How was the Central Bank Council composed in the first few months, against the background of this controversial debate? Among the members of the Central Bank Council, only Karl Mürdel had belonged to the Nazi Party (NSDAP). Only four of thirteen Central Bank Council members came from the former Reichsbank (Eugen Christian Hinckel, Ernst Hülse, Karl Mürdel and Wilhelm Vocke). Of the remaining nine, seven (Karl Bernard, Otto Burkhardt, Karl Klasen, Otto Pfleiderer, Max Sentz, Hermann Tepe and Otto Veit) had experience of banking, in some cases combined with academic experience of banking issues. Bernard had, moreover, worked for years in the Reich Economics Ministry; he therefore – unlike Abs – conformed to the US and British notion that the head of a central bank should have a different "mentality" from the head of a commercial bank. Only two members (Wilhelm Boden and Max Grasmann) had no particular experience of banking. Grasmann (who had worked in industry and the insurance sector) had, however, – like Hülse, Pfleiderer, Tepe, Veit and Vocke – been a member of the Commission of Experts "Länder Union Bank". Bernard and Pfleiderer were, moreover, members of the Money and Credit Special Agency. Among the top executives of the Board of Managers, there was in the first few months, apart from Wilhelm Vocke, only one other ex-staff member of the former Reichsbank: Wilhelm Könneker; Viktor Wrede and Erich Zachau were specialists who came from outside.

The Allies did not agree to the election of Otto Schniewind and Hermann Josef Abs as Chairman and Deputy Chairman of the Central Bank Council, respectively, because – quite apart from the above-mentioned demand for an amendment of the law, which was unacceptable to the Allies – neither satisfied the special political standards already specified; they would have met the usual denazification requirements.

The French, with their particularly decentralised approach, wanted the two top positions in the Bank to be filled from the ranks of the Land Central Bank Presidents. By first nominating Schniewind and Abs, and then Bernard and Vocke, the Land Central Bank Presidents failed to comply with that wish. Even though, like most of them, those Presidents did not come from the Reichsbank, they, like the members of the Commission of Experts "Länder Union Bank", were anxious to incorporate a number of supra-regional stabilisers in the decentralised structure of the Central Bank Council.

The first few years of probation

Before the establishment of the Bank deutscher Länder, German commentators had strongly criticised its dependence on instructions from the Allies and the extremely decentralised composition of the Central Bank Council. How did the Bank deutscher Länder cope with those problems during the first few years of its existence?

The Allied Bank Commission decided to implement the currency reform against the wishes of the Central Bank Council ...

At the end of the day, the Bank deutscher Länder passed a more favourable verdict on the Allied right to issue instructions than the German experts had done early in 1948. Overall, the degree of agreement between the Bank deutscher Länder and the Allies was comparatively great. The propensity of the Allies, in the event of differences of opinion, to impose their views on the Bank deutscher Länder was relatively small. That did not apply – as described above – to the initial appointments to the two top jobs in the bank. Nor did it apply to the implementation of the currency reform: the Allied Bank Commission did not involve the Central Bank Council – as the latter had requested – in the technical reviewing of the currency reform legislation, nor did the Allies (acting under French pressure) curb statutory money creation in the summer and autumn of 1948 to the extent desired by the Central Bank Council. After all, the Central Bank Council regarded the prompt outpayment of the second per capita sum of DM 20 and the release of one-fifth of what was known as the "blocked account" as a threat to the currency.

... but it influenced the monetary policy decisions of the Central Bank Council only to the extent of modifying them

The decisions on the currency reform, however, were solely the responsibility of the military governments, rather than of the Bank deutscher Länder. Yet the Allies, or their executive arm, the Allied Bank Commission, influenced the decisions taken in the actual field of responsibility of the Bank, i.e. the deployment of its monetary policy instruments, only to the extent of modifying them. Both the Bank deutscher Länder and the Allied Bank Commission assigned priority to the objective of monetary stability. They differed at times in the intensity with which they pursued that objective, and above all in the monetary policy measures deployed. In such cases the Allies endeavoured to influence the Bank deutscher Länder in the desired direction but, if their proposals were disregarded, they made scant use of their right to issue instructions.

For instance, on June 24, 1948, a few days after the currency reform, the Central Bank Council refused to comply with the Allied Bank Commission's wish for an increase in the discount rate, to 8 %. In autumn 1948 it tried to contain the sharp price rises by imposing credit ceilings and selective credit restrictions; the Allied Bank Commission, though internally divided on the issue, had wanted to deploy the more market-oriented instrument of raising the discount rate. In autumn 1949 the Allied Bank Commission endeavoured to restrain the Bank deutscher Länder's provisional financing measures for stimulating economic activity; in the early months of 1950, by contrast, it urged the Bank to engage in more expansionary provisional financing of job-creation measures –

on both occasions with only partial success. In October 1950 the Allies made the granting of a special credit – in the context of the European Payments Union – to overcome the German balance of payments crisis dependent on the pursuit of a more restrictive monetary policy by the Bank deutscher Länder. To this extent, they played a part in the sharp increase in the discount rate in October 1950 (from 4 % to 6 %), approved against the wishes of the Federal Chancellor, an increase that enhanced the reputation of the Bank deutscher Länder as a stability-oriented central bank.

In the course of those first few years, the Bank deutscher Länder came to respect the Allied Bank Commission as a major confidence-building factor. It viewed the Allied Bank Commission as a reflection of international responsibility for an uncovered currency in a new nation that was still an unknown quantity in monetary terms. When, at the request of the Allies, the right of the Allied Bank Commission to issue instructions was to be abolished in 1951, the Central Bank Council wrote: "its (the Commission's) right to issue instructions has, rightly, mostly been regarded in Germany and abroad as having the significance of a guarantee against monetary policy experiments."

The underlying counter-inflationary consensus helped the Bank to cope with the challenges of the first few years

During the experimental phase of the first three years, the west German central banking system was faced with several major challenges: a steep rise in prices in the months immediately following the currency reform, when a pent-up demand for goods unwound; growing unemployment until mid-1950 owing to the inflow of refugees; and a fresh upturn in prices during the Korea boom as from the autumn of 1950. In coping with these challenges, did the stringency and uniformity of monetary policy suffer in the light of the decentralised, two-tier structure of the central banking system? The answer to this question is mixed:

The debates of the Central Bank Council were distinguished by a broad underlying counter-inflationary consensus. But views on the extent to which such factors as the short-term buttressing of business activity and employment should be taken into account, and on the appropriateness of deploying monetary policy instruments, differed. Over and above all differences of opinion, however, the stability-oriented stance of monetary policy won through in the end.

Examples of that stance are the measures taken to curb price rises in autumn 1948 and from autumn 1950. In November, the Central Bank Council decided not only to raise the minimum reserve ratios but also, as mentioned above, to rediscount selected bankers' acceptances and introduce all-round credit ceilings. Between September 1950 and March 1951, the Central Bank Council once again decided both to increase the minimum reserve ratios and raise the discount rate and to resort (against the wishes of Federal Chancellor Adenauer) to quantitative restrictive measures, in order to combat inflation: first, a limitation of the volume of acceptances, and of the commercial banks' entire recourse to the Land Central Banks, then a credit ceiling (this time backed by sanctions).

These decisions fell short of what Vocke had demanded: in 1948, primarily a further increase in the minimum reserve ratios, accompanied by a raising of the discount rate; in 1950, stricter quantitative restrictions and a further raising of the discount rate. Even so, the decisions reflected a marked determination on the part of the central banking system to aim at price stability. This situation was not altered by the fact that the conditions of the quantitative credit restriction were met only imperfectly (in part, the increase in lending merely slowed down; in part, the targets for reducing lending were not reached, or were circumvented). The quantitative credit restrictions were modelled on similar measures taken by the Reichsbank during the period of the Weimar Republic; it was widely believed that, at times of a high propensity to incur debt, borrowing could not be reduced by raising the discount rate.

The less-than-perfect execution of the imposition of quotas and of ceilings brought to light another problem: the decisions of the Central Bank Council were "directory", rather than mandatory, provisions which left the Land Central Banks some latitude in their implementation. The Land Central Banks, at their discretion, allowed special features to count vis-à-vis individual credit institutions. Hence they implemented the restrictive decisions in very different ways overall. That adversely affected the uniformity of monetary policy. The Allies took advantage of the unsatisfactory implementation of the 1950-1 decisions to impose quotas and credit ceilings to question the viability of the decentralised, two-tier west German central banking system. Their criticism could, however, also have been levelled at the instruments chosen. The (exclusive) deployment of instruments consistent with market conditions would not have opened up the above-mentioned room for discretion in the implementation of the measures.

In the first few years of its probation, the Central Bank Council started to exploit its freedom from instructions in order to oppose the wishes of the Federal Cabinet. At the same time, close contact with the Federal Cabinet began. Dependence on the Allied Bank Commission actually gave the Bank more protection, rather than cramping its style.