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Recovery and Reconstruction in West Germany

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After the collapse in May, 1945, Germany west of the Oder-Neisse line, was divided by the occupying powers into four zones. In 1948, one of those zones was separated by the iron curtain from the other three and became the Soviet Zone, incorporating what was formerly Mid-Germany. The three other zones, under British, American and French control, were combined as West Germany and there the self-governing "Lands," corresponding to the former States therein, were constituted and given diverse powers over finance. Their budgets had to provide for their newly established civil service besides supporting the refugees driven from the former German territory beyond the Oder-Neisse line and from the Sudetenland and, in addition, they had to bear the costs of the military occupation. Food was the first consideration. The hard work of German peasants and the supplies provided by the Western Powers saved the people from dire starvation. It took all the longer to restore the country's industries. For what had not been razed during the war had to suffer that dismantling of plant and machinery which was part and parcel of the Morgenthau plan to convert Germany into a pastoral community.

By the time of the capitulation in May, 1945, no fewer than two and a quarter million houses had been destroyed in West Germany, their occupants evacuated out into the country and far from their place of work. Adding to them the fugitives from the East, the number of displaced persons grew from ten millions at the end of the war to eleven millions. At this stage the "planned economy" taken over from the Hitler regime served at least to spread out more or less evenly the lack of food, clothing and shelter. Through the inflation during the war, money had lost its purchasing power. Barter on the black market followed and it was from there that bakers, butchers, inn-keepers and other such businesses were the first to be supplied with materials necessary for rebuilding. "Land reform" as a means of stripping the Junkers of their political sway was discredited by the occupying powers in the Western Zone, since, as they said, it was not in West but in East Germany that the great estates lay.

The Currency Reform

It was only when Communism, spreading from the bolshevised Eastern Zone, began to threaten West Germany (and West Europe as a whole), that this attitude was changed. The first step taken towards mending economic conditions was the currency reform of June 21, 1948. While this ensured the West Germany Lands against state bankruptcy, it destroyed all the savings of the middle classes who for a second time in a generation were thus despoiled. But with this currency reform there was no reduction in taxation, the occupying powers holding to the idea that stiff taxation was the way to get rid of the surplus money supply created by the war inflation. On top of that came the war damage contribution*, with its immense complexity of ordinances and their amendments. For this war damage levy, capital assets, other than real estate, were much more heavily taxed than real estate itself, the former being taken in at full value whereas the latter was charged on the basis of assessments arbitrarily "pegged" at a low figure.

The West German Federal Government was constituted by a "provisional" statute on May 8, 1949. This law contained certain complicated provisions governing the taxation

* See Appendix.

that could be imposed respectively by the Federal Government and the several autonomous Lands, which made impossible any uniformity of administration or financial policy. It led to serious frictions in contests over the sharing of the revenues.

Production goes ahead

In spite of those heavy handicaps the Federal authorities, by liberating home and foreign trade from the restrictions of the planned economy, succeeded in speedily raising both agricultural and industrial production. The displaced persons were gradually taken into employment and an earnest start was made with the rebuilding of the war-damaged cities. The gross national product rose from 80,000 million marks in 1949 to 146,000 millions in 1954 and it is expected to exceed 154,000 millions in 1955. The rebuilding involved an immense capital expenditure which rose to 25 per cent of the national production in 1951 and to 27.3 per cent in 1954, as compared with the normal 7 to 10 per cent in 1900. The annual output of new dwellings increased from 215,000 in 1949 to 500,000 in 1954; and with altogether 2,405,000 built by the end of 1954, the new dwellings exceeded in number the dwellings that had been destroyed during the war. Nevertheless not more than half of the housing needs of the people has yet been satisfied.

Public Expenditure

While the standard of living in the Soviet Zone of Germany fell to that prevailing among the Balkan peoples, in West Germany it now has the outward sign of approaching the standards of neighbouring Western countries. However much this result may be attributed to the vitality and energy of the German people it would be a mistake to regard it as an "economic miracle." That would be to overlook the deterioration in the social structure and in the economic, financial and political situation that has arisen through the collapse. A glance at the budgets, for year 1955/56 of the Federal Governments, the Lands and the Local Authorities reveals that out of a total anticipated production of 154,000 million marks about 48,500 millions represent public expenditure. After deducting expenditures on capital investments, cost of insurances, etc., there remains not more than 56 per cent of the total as income for private enjoyment. This means that producers have to work for almost six months of the year for the State.

The expenditure of the 48,500 millions is made up as follows:—

	per cent
Social services and post-war expansions (pensions, etc.)	22.6
Public debt charges	4.1
Administrative expenses, including subsidies	23.6
Capital expenditure and general services ...	30.8
Military occupation and the defence forces	18.9

Of these expenditures, social services and public debt charges have a tendency to increase. The future costs of the occupation and of the defence forces will depend upon the course that foreign policy takes. The " Union of Taxpayers " whose aims are to bring the finances of West Germany into a healthier state is therefore concerned with reducing the expenditure on administration, subsidies, general services and investments. Here it is faced by the stubborn resistance of the administrations, whose extravagance is conditioned by the particularism of the Lands as well as by the centralism of the Federal Government. Not only so; there is the opposition of the Parliaments whose happy-go-lucky members would rather satisfy their voters with further hand-outs than make themselves unpopular by cutting expenditure.

Present Sources of Revenue

West Germany regained sovereignty in May, 1955. Now it faces the necessity of fundamental reforms in its taxation and financial systems, in its constitution and administration, if its own social and economic structure is to be put on a thoroughly healthy basis. Thereby it will be better equipped for the difficult task of bringing about the reunification of West and East Germany.

The following table shows the percentages of the total revenue attributable to the various taxes levied:—

	per cent
Sales taxes	26.3
Income Tax on declared personal incomes...	13.4
,, ,, deducted from wages	11.5
,, ,, paid by companies only ...	9.0
Trade taxes paid by all undertakings ...	8.6
Tobacco taxes	7.5
Real estate taxes	3.7
Customs duties	3.5
Subventions in aid of Berlin	2.3
21 other taxes on trade and consumption ...	14.2

Out of this revenue the Federal Government received the whole yield of the sales taxes and 40 per cent of the income and corporation taxes levied by the Lands, also other taxes, making up about two-thirds of the aggregate taxation from all sources. The remaining third was divided in about equal parts between the Lands and the Local Authorities. The unavoidable expenditures of the Federal Government on social services and on military occupation and defence increase at a greater rate than those of the Lands. It is therefore a matter of serious concern that the Federal Government obtains such a large part of its income from the sales tax because this is always passed on to customer and consumer; through its well-known snowball effect it inflates market prices; it gives occasion for ever higher money wages and it endangers the stability of the currency. Trade and industry are repeatedly taxed by the income, business and corporation taxes and with uneven incidence.

The Stiffening Price of Land

About half of the real estate taxes (yielding 3.7 per cent of the total tax-revenue), falls upon land values. Taking into account the further burdens imposed through the war damage levy and the income taxes, land rents bear about 3 per cent of the total taxation from all sources. Yet their part of the national production may well have arisen from 5 per cent in 1950 to 6 per cent or more in 1955. Since at the same time national production has risen from 90,000 to 154,000 million marks, this means an actual doubling of the under-taxed rents of land and a corresponding increase in the amount of land rent that is privately appropriated. And that increase, because of the "pegged" assessments for real estate tax purposes, escapes taxation. In large cities like Düsseldorf, Bonn and Stuttgart where there has been great building activity, land prices between 1950 and 1955 have been trebled. In other towns and in the country they have been doubled and it is only in war-damaged districts, not yet being rebuilt, that there is a slow increase in land prices.

Thus the West German tax system, by the under-taxation of land rents and the over-taxation of labour and capital has raised the prices of land and the prices of materials to exorbitant levels. Hardest hit by this two-fold rise in prices is the building of houses, and, to meet the situation, necessity compels the pouring out of more and more subsidies. The money for these subsidies has to come from taxes levied on labour and capital and so, at the expense of taxpayers, it merely flows to the landlord as an unearned gain instead of doing anything to solve the housing problem. By this tax system and this mistaken subsidy policy the supply of sites and dwellings is restricted, and this at the time of a most pressing housing shortage. It is thus that most of the building of houses by the State or municipality takes shape in huge blocks of very small flats. The government had the one great opportunity after destruction by war to encourage home ownership; but that they missed. Similarly, through ever-increasing land prices, land settlement with new farms and smallholdings has come to grief. For the very many displaced peasants only 56,000 holdings had been established by the end of year 1954, the means to that end coming from the war damage compensation funds. The many disappointed peasants had to look for other occupation, or emigrate.

Needed Financial Reforms

Kurt Schmidt in his Conference paper at the New York International Conference, 1939, showed how between the two wars the greater part of agricultural Germany had become monopolised as the result of Hitler's law establishing the entail of farms (The *Reichserbhofgesetz* of September, 1933). This law was repealed in 1945, but its repeal did not help to throw land open for use, as the land was still "pegged" at the 1936 price level by the Stop-Price Law of November, 1936, and landowners were more inclined to hang on to their land than to sell it. In the cities, since 1918 rent controls have put difficulties in the way of private house-building. Again, because of the absence of any land-value taxation and reformed town and country planning, the Housing Law of May, 1920, which aimed to promote house-building completely failed, in spite of all the late Adolf Damaschke's efforts to interest the local authorities in its enforcement.

The average German in his efforts to provide the means for his daily livelihood shows little or no interest in fundamental questions connected with finance and taxation. To him it seems sufficient that industry has doubled its production within ten years and that agricultural production has considerably surpassed its pre-war maximum. Cultivable land is not left idle. In the cities, however, there are plenty of those gaps, those vacant building plots, which would soon be developed if the principles of land-value taxation were applied. There, two policies are vocal. On the one hand, the landed interests insist upon the repeal of the laws that prevent the raising of rents. On the other hand, the trade unions and the tenants' associations insist that rent restrictions be maintained and they demand the investment of public funds in subsidised house-building. Nevertheless it has not been overlooked by those in authority that, if there is to be a healthy municipal housing policy, it must start with the land.

Land-Value Taxation being Considered

In 1946, government circles in South German Lands were prepared to consider legislation for the taxation of land values, but for one reason or other the matter was suspended. In 1950, the Federal Government resolved in favour of a land valuation which would abolish the pegging of land prices as had been required by the legislation of November, 1936, and it called for measures to prevent speculation in land and the unearned gains derived therefrom. Since then the Federal Housing Ministry has been working on the draft of a law whereby increases in land values would be taxable by the Local Authorities, and this apart from the real estate taxes already in existence. But this proposed action by the Federal Government, requiring land-value assessments to be made by the Local Authorities, was ruled by the Courts to be unconstitutional.

The Housing Ministry, now persuaded that the place for those provisions is not within the building laws, is aiming to have them embodied in the laws governing the real estate taxation. That, however, can only be achieved when a valuation is made separating the value of land from the value of improvements. Thus agitation for land tax reform is well on its way. Since, however, the real estate taxation is administered by the governments of the Lands, and since they cannot amend that unless empowered by the Federal Government to do so, it may take some time before a law is passed providing for the separate valuation of land apart from improvements and the taxation of land values incorporating also increment taxation.

Draft Legislation Prepared

The author himself has contributed to those studies in two publications* in the course of which he described the operation of land-value taxation in other countries and made recommendations as to its practical application in Germany. In March, 1955, he submitted a Bill in which his estimates showed that right-away a 2½ per cent tax on land values would suffice to free all buildings from the real estate tax. If the land-value tax were to be gradually raised within ten years from this 2½ per cent to 4 per cent, then the Trade

* Martin Pfannschmidt: *Die Bodenrente im Raumwirtschaft und Raumpolitik* (The Place of Land Rent in the Economic and Political Field). Published by Dorn, Bremen-Horn, 1953. And: *Die Bodenwertbesteuerung in der Steuer—und Finanzreform* (Land-Value Taxation and Fiscal and Financial Reform). Published by the Verlag für Socialwissenschaften (Social Sciences) Frankfurt on the Maine, 1955.

Tax could also be wholly remitted. The industrialists and the Union of Taxpayers demand the abolition of that tax because of its harmful effects and because of its double and most unequal burden. On the other hand, since that trade tax is the main source of Local Authority revenues, the Local Authorities will stand by it, and will only give it up when an equal amount of revenue is guaranteed to them by means of the rating of land values.

For the technical details of how to implement the taxation of land values, the Danish Land Value Tax Act of 1922 provides an invaluable guide, so also the British Finance Act of 1931. Translations of the texts of these measures were submitted along with the draft Bill that has already been mentioned. These documents and the publications already mentioned are at the service of the government departments and all interested parties. It is material that may help to show how the long overdue land tax reform can at last be realised. Those who are engaged in the matter and the Government departments will, it is hoped, be able to see how, through this reform, land use and housing development, to-day held down by coercive regulations and controls, can in a few years be rescued and lifted on to the plane where the free market economy prevails. In order to reach this goal the legislation for the taxation of land values should be accompanied by reforms in town and country planning so that full scope is given to co-operative enterprise and reward is fully assured to the long-term investments whether of private individuals, the Local Authorities or the State.

APPENDIX

Note on the War Damage Contribution

Provision for war damage compensation was made in the Law of 2nd September, 1948, confirmed by the Law of 14th August, 1952. A levy was raised on property including land and buildings, working capital and stock in trade, all taken at its declared value as on 21st June, 1948. Also embraced in the levy were gains derived from the currency reform. In total, the levy amounted to 60,000 million marks which with interest at 4 to 6 per cent per annum had to be discharged during the years 1949 to 1979. In the case of landed property the levy was at the rate of 50 per cent on the old-standing assessments (for real estate taxation) which were anything from a quarter to a tenth of the actual market value. Special provisions applied to mortgaged property whereby 90 per cent of any gains (resulting from the currency reform) became the property of the governments of the Lands. From 1949 to the end of 1954, approximately 14,000 million marks had been paid in the name of this War Damage Compensation Levy. Out of this money the following purposes were served: 3,839 millions on war disablement and war pensions; 2,479 millions restoration of household goods; 1,004 millions aid to private businesses and professions; 500 millions aid to farmers and 4,620 millions towards the rebuilding of houses.

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