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1. Introduction: Purpose of the German-Japanese Comparison

Two nations defeated by Allied Powers, both with currencies ruined by government expenditure excesses due to the war effort and with central bank portfolios loaded with relatively worthless government paper, lend themselves to a comparison of post-1945 central banking reform. It is true that the sovereignty of the German Reich had completely vanished with Germany's unconditional surrender and the country was partitioned among the Allies, while the Japanese state remained intact and the country remained united under American occupation. But as the Americans, due to their financial strength, also played a leading role among the three occupying powers of West Germany, it is especially useful to compare the aims and results of American banking policies in Japan and Germany under the partly equal, partly different conditions. Especially in the financial and economic field, there were cases in which even the persons responsible for planning and executing policies in Germany and Japan were identical. Joseph M. Dodge first served as financial adviser to the American military government in Germany and was later sent in a similar function to Japan. The same is true for William H. Draper, who was General Clay's economic adviser in Germany and later also served in Japan.

Such a comparison enhances the chances of success in attributing causes to observed developments in central banking policies. Did American policy plans fail, because the outbreak of the Cold War changed the U.S. policy priorities, because German or Japanese politicians opposed U.S. policy objectives or resisted the implementation of such policies, or because the U.S. was meeting with opposition from its Allies in Germany? It is this sort of question that the paper can help to answer. The international comparison - as always - increases the number of variables to solve a given set of equations.

2. The institutional setup of the central banking system up to 1945

2.1. Germany

When the Reichsbank - the Prussian Bank bought from Prussia by the newly-founded Reich - came into existence on 1 January 1876, it was a centralized institution in Berlin with subsidiaries all over Germany.[1] The owners of the Reichsbank were private stockholders. Their annual *General Assembly* elected a 15-member Central Committee, which closely monitored monetary policies and performed advisory functions, especially in credit policy matters and in the appointment of members of the Directorate. The Reichsbank was not yet exclusively a „bank of banks"; it also did business with nonbank enterprises, especially from the manufacturing and agricultural sector. Until 1922 it was not independent of the government, but was directly subordinated to the Reich's Chancellor who was explicitly designated the head of the Reichsbank in the Banking Act of 1875. The Directorate of the Reichsbank and its president, all civil servants of the Reich appointed for life-time tenure by the Kaiser, were merely executive organs. Somewhat typical for central banks in the pre-World-War-One period, the Reichsbank displayed a mixed status between private ownership and government control.

Although the Bank was a centralized Reich institution, the states had retained some rights. The federal chamber of parliament, the *Bundesrat*, which represented the different states of Germany, nominated the Reichsbank president and the members of the Directorate. It also appointed three out of four members of the supervisory body, the *Kuratorium*, which was automatically chaired by the Chancellor himself.

As long as the Reichsbank was obligated by law to keep one third of its note circulation covered essentially in gold, the Reich government could hardly interfere in monetary policies and never exploited the printing press. This changed when the gold-cover requirement was lifted with the outbreak of the First World War in August 1914. From then on the Reich government had practically unlimited access to the printing presses of the Reichsbank with the familiar inflationary and hyperinflationary consequences during the war and postwar period until November 1923.

An important legal change in the Reichsbank status vis-à-vis the government came about on 26 May 1922. On demand of the Allies as a condition for a moratorium on reparation payments, the *Autonomy Act* became law in Germany. The Reich's Chancellor ceased to be the

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[1] This chapter is based on Holtfrerich (1988), pp. 107-139.

head of the Reichsbank and the Reichsbank could decide on monetary policies on its own. Nonetheless, The Reich's supervisory body, the *Kuratorium* with the Reich's Chancellor as its Chairman, remained in place. But the procedure of appointing the Bank's President and the other members of the Directorate was also changed. From then on, the Bank's President could be nominated by the *Reichsrat* (as the second chamber of parliament representing the states was called in the Weimar Republic) and be appointed by the Reich's President only after the expert opinion of the Central Committee and of the Directorate had been heard. The Directorate members were co-opted, i.e. nominated by the Directorate and - with the consent of the *Reichsrat* - appointed by the Reich's President after the opinion of the Central Committee had been heard.

The Allies had hoped that more Reichsbank independence of the government would stop the inflationary process in Germany. Instead the Reichsbank, which previously had criticized the government for its budget deficits and had pointed to their inflationary consequences, did not resist the government's demand for monetizing the progressively growing deficits. By starting to discount commercial bills on a big scale besides treasury bills, it opened the floodgate for Germany's famous hyperinflation that began in June 1922. Hjalmar Schacht, Reichsbank president from the end of 1923 to 1930 and again from 1933 to 1939, explained this by arguing that on account of the unfortunate foreign policy situation of Germany, the Reichsbank lacked the will to restrict the Reich to its own financial means (Schacht 1927, p. 117). One of the responsible members of the Bank's Directorate, Karl Friedrich, stated shortly after the event that at the time the situation did not allow the full utilization of the Reichsbank's legal autonomy. The question of what would happen if the Bank simply refused its credit to the Reich had been examined and answered to the effect that the denial of credit most probably would have had economic and political consequences much worse than the monetary implications of further credits to the government (Friedrich 1923/24, p. 342). The case demonstrates that central bank independence might be a necessary, but is not a sufficient condition for providing stable monetary conditions.

Karl Helfferich, who was favoured by the Reichsbank Directorate as the successor to Rudolph Havenstein as president of the Bank, when the latter had conveniently died just at the end of hyperinflation in November 1923, also published on his view of the issue. In a judgment typical of conservative and nationalist circles, he pointed out that the *Autonomy Act* had not been a voluntary action by German legislative authorities, but „the execution of a dictate" by the Allies. He nevertheless approved of the change arguing that in the new republican-parliamentary system the Bank needed protection from interference by partisan and non-expert governments (Helfferich 1921/22, pp. 215-217). Others opposed the Bank's autonomy on the grounds that it was alien to the German tradition (Singer 1922, pp. 734-735).

As part of the Dawes Plan Reparation Treaty between Germany and the Allies, the old Reichsbank of 1875/76 was put on a new legal footing.

The structure of the new banking law and the new Reichsbank resembled that of 1875. The main difference was that the 1924 banking law stipulated the independence of the Bank vis-à-vis the government. The Directorate was given the final say in shaping credit policies. The Reichsbank was merely obliged to *report* to the government on its credit policies and not to *support* the overall economic policy of the government, as the Bundesbank is obliged to do today. Even in matters of appointing the Directorate and its President, the Reich's authority was much reduced. The Reichsbank President and the ordinary members of the Directorate were to be elected by the newly created *General Council* that consisted of seven German and seven foreign members. It succeeded the *Kuratorium* through which the Reich had previously supervised the Bank. The German members of the General Council were elected by the private owners of the Bank, represented in the General Assembly, which had been in existence since 1876. The only influence that the Reich retained was the Reich's President's right to veto the appointment of an elected Reichsbank President twice. The third time around, however, the Reich's President was obliged to carry out the appointment.

The life-time tenure for the members and President of the Directorate was removed. Directorate members were appointed for twelve years, and they had to resign at the age of sixty-five. The President was appointed for four years. Reelection as well as revocation at any time of members or the President of the Directorate by the General Council were possible. The Central Committee, elected by the General Assembly, was retained as an advisory body.

A completely new institution was the Commissioner for the Note Issue who had to be a foreigner. He was to ensure that the banknote circulation was managed according to the law, in other words that inflation would not be repeated.

With the same purpose in mind, § 25 strictly limited the Reich's access to the Reichsbank's credit to a total of 100 million Reichsmarks and to a three-months term at most. At the end of each business year the Reich was not allowed to have an outstanding Reichsbank credit at all.

In this way, the Reichsbank was completely cut loose from the German government. Instead, it was subjected to influence by foreign agents, albeit legally to a lesser degree than during its subordination to the Reich's Chancellor from 1876 to 1922. But the Reichsbank and the foreign agents were operating under the same rules, those of the newly established gold-exchange standard: The Reichsbank was obliged to cover its note circulation by at least 40 percent in gold and foreign exchange instead of the 33.3 percent gold coverage requirement before the First World War. The remaining 60 percent were allowed to be covered by qualified commercial bills and checks.

Another revision of the 1924 banking law that followed the acceptance of the Young Plan in 1930 eliminated the control foreigners had exercised over the Reichsbank. The position of the Commissioner for the Note Issue was abolished. The General Council consisted of German members only, thus strengthening the influence of the Bank's private owners. At the same time, however, the Reich's President was given the ultimate right to veto the appointment or the revocation of members of the Reichsbank's Directorate and of its President. This strengthening of the powers of the Reich's President, in fact, amounted to a strengthening of the government's role, because his decision had to be countersigned by the Chancellor or the cabinet member in charge. In addition, the Bank was allowed to accept treasury bonds on collateral for lombard credits, thus easing the Reich's access to the Bank's credit.

While the Bank's independence of the government had been strengthened under the Banking Act of 1924, its room for manoeuvre had been curtailed by subjecting it to the rules of the gold exchange standard and by establishing foreign supervision to ensure that those rules would be guarded. When foreign supervision was terminated in 1930 after the acceptance of the Young Plan, full convertibility of the German currency was introduced legally also for Germans. This strenghened the gold exchange standard's grip on the conduct of German monetary policy. When foreign exchange control was introduced in Germany after the financial crisis in the summer of 1931, after which the Reichsbank also failed to meet the 40 percent coverage requirement, the Bank's dependence on the rules of the gold exchange standard was again weakened.

Throughout this post-inflation period, Germany's central bank enjoyed a freedom of action vis-à-vis the government that it had never had (or used from May 1922 to November 1923) before and that it would never retrieve. It was a period of extreme tension between the government and the Bank (Müller 1973).

The Reichsbank even used its power to dictate fiscal-restraint legislation to the govenrment. Its pressure contributed to the instability of Weimar governments and to the rather low prestige that the Weimar Republic enjoyed in public.

During the Nazi period (1933-1945), the Reichsbank was gradually subjected to total control by the Reich. For, the principle of divison of power is alien to a totalitarian state. Furthermore, the Nazi government needed complete subordination of the central bank in support of its war efforts.

The *Banking Act* of October 27, 1933, again revised the banking law of 1924. The General Council, through which the private owners of the Bank had exercised an important degree of control over the Reichsbank, was abolished. The Bank's President was to be appointed by the Reich's President, after hearing the opinion of the Bank's Directorate. The Directorate members were to be nominated by the Bank's President, but appointed by the Reich's President. In addition, the right to revoke Directorate members or the Bank's President was transferred from the General Council to the Reich's President alone.

The Reichsbank was empowered to trade on the open market in treasury and regular bonds without any limitation. This not only meant the introduction of a new instrument of monetary policy, the open market policy, but also easier access to the Bank's credit for the Reich. The Reichsbank was authorized to fall short of the 40 percent coverage requirement, subject to majority decisions by the Directorate and the Central Committee.

The next legal change came about on January 30, 1937, this time by a simple declaration of the *Führer* in the Reichstag that the Reich had resumed unlimited sovereignty over the Reichsbank. It is not a coincidence that it took place on the fourth anniversary of the Nazis' seizure of power. This declaration was the final breach of Germany's international obligations from the Treaty of Versailles, in particular those that concerned the Reichsbank and still provided for a participation of the Bank for International Settlements (BIS) in changes of the German central banking law. The Reich's government, not the Reichstag, passed a law accordingly on February 10, 1937. It stipulated - similar to the law of 1875 - that the Reichsbank Directorate administered the Bank, but that it was subordinated to the *Führer* and Reich's Chancellor.

The final reform came about when shortly before World War II the Reich's government passed the *Banking Act* of June 15, 1939. The Bank was now totally subordinated to the Nazis' policy aims and to the *Führer*. The introduction to the Act stated that the Bank was subjected to the Reich's unlimited sovereignty and that it was obliged to support the realization of aims set by the Nazi leadership within its field of functions, "the safeguarding of the value of the German currency" being mentioned as the Bank's prime duty.

The Bank's Directorate was subjected to instruction and supervision by the *Führer* and Reich's Chancellor. The Directorate merely administered the Bank. Its decisions were no longer taken by majority vote, but by the Bank's President alone. The *Führer* was given the exclusive right to appoint and revoke the Bank's President and the members of the Directorate. The Bank's private owners retained their *General Assembly*, but were left powerless. The Central Committee was abolished and substituted by an advisory council with members chosen by the Bank's President alone.

In addition to bonds the Bank was from now on allowed to trade in treasury bills, the total amount of which was left to a decision by the *Führer*.

All minimum coverage requirements for the Reichsbank's note issue were dropped. Gold and foreign exchange reserves should only suffice to clear accounts in international transactions and to safeguard the external value of the German currency. Whatever portion of the note issue was not covered by gold or foreign exchange, could be covered by commercial bills and checks, the Reich's treasury bills, bonds and lombard credits on daily notice.

Thus, the *Führer* had attained total control of the Reichsbank and an unlimited access to its credit.

In January 1939 Reichsbank President H. Schacht and his Directorate had protested the ongoing use of the printing press by the Nazi government to finance the massive expenditures for armaments. Although Schacht had helped to pave the Nazis' way to power, he and other members of the Directorate were immediately dismissed by the *Führer* and replaced by politically more streamlined and at the same time less expert figures. During the war from September 1939 to May 1945, the Reichsbank never resisted any government demands for credit.

2.2. Japan

The Bank of Japan (BOJ) was established in June 1882 as a joint-stock company, modelled after the Belgian National Bank. The Finance Minister, Masayoshi Matsukata, accepted an advice from Leon Say, the French Finance Minister, to follow the Belgian example because of its relatively recent establishment in 1850. However, why the model of the German Reichsbank, even more recently established in 1876, was not chosen is still a puzzle. Yoshino (1962, p.116) guessed that the strong governmental control over the Belgian central bank attracted Matsukata's attention. Indeed, the BOJ's dependence on the government was quite evident from the beginning: as in the Belgian case, the government had the power to authorize any revision of the Bank's Article and to nominate the Governor. But half of the BOJ's stock capital was owned by the government, while the Belgian counterpart had solely private stockholders. Another reason for choosing the Belgian model seems to be a similar monetary problem at the outset. The establishment of the Belgian National Bank constituted the decisive element in Belgian monetary stabilization after the inflation that had been caused by the over-issue of inconvertible currency.

Matsukata was also faced with an inflationary situation and pursued a deflationary policy. He drastically contracted the inconvertible government currency that had been issued during the Seinan-War (a large-scale rebellion of the former *Samurai*) from the peak of 139 million yen in 1878 to 88 million yen in 1885. The foundation of a central bank to issue bank notes convertible into specie was expected to be the final act of his monetary reform. However, the statutes of the BOJ Act did not include a clear rule for its note issue. Because the inflation was not yet completely under control, the government had to permit the circulation of inconvertible currencies (not only government paper currency, but notes issued by commercial banks as well) at least for a while, after the BOJ had been founded in 1882. The convertibility of the BOJ notes took effect only in May 1885. The amended Convertible Note Act of 1888 finally stipulated a limit for the BOJ's note issue: The maximum was equal to the BOJ's specie reserves plus a fiduciary amount (70 million yen plus allowance when necessary, with tax payments and permission by the Finance Minister). Nevertheless, the circulation of the inconvertible currencies continued a few more decades, being overtaken by that of the BOJ notes in 1889 and terminated finally in 1899.[2]

Although the Japanese monetary standard was initially based on silver, the indemnity of the Chino-Japanese War enabled Japan to adopt the gold standard in 1897, with gold purchased in London. This episode reminds us of the similar history that German gold standard was adopted with the indemnity of the Prussian-French War. The BOJ did not strictly change money supply in accordance with its gold reserves, however, because the *Zaigai Seika* (specie and foreign exchange held abroad) worked as a cushion when the balance of trade registered large deficits, and hence gold flowed out of Japan.

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[2] For the prewar history of the BOJ, see BOJ (1984) and Yoshino (1962).

During the First World War, Japan enjoyed a windfall demand for her exports and recorded the highest level of current account surplus (more than 10% of GNP) in her modern economic history.[3] Since the United States and other industrial countries suspended gold exports, Japan followed suit in September 1917. Although Japan tried to resume gold exports and reestablish the gold standard through the 1920s, financial crises in 1920 and 1927 prevented these efforts. Therefore, the most important task for the BOJ in this period was its lender of last resort function, namely to assist financial institutions in difficulties by providing emergency credit. In January 1930 at last, after a considerable delay compared with other industrial countries, the gold standard was reintroduced in Japan at the prewar parity, but it was suspended again in December 1931.[4]

Shortly thereafter, the maximum limit of the BOJ's fiduciary note issue was extended from 120 million to 1 billion yen in July 1932, and up to 1.7 billion in April 1938, again up to 2.2 billion in April 1939, respectively. These repeated measures corresponded to a policy of monetizing government bonds which financed the increased scale of military spending. In addition, a new BOJ Law was enacted in May 1942, following the German Reichsbankgesetz of 1939, and simultaneously the previous acts dealing with the BOJ and its note issue were removed. As a result of its duty "to accomplish solely the national purpose" (Article 2 of the Law), the monetary authority was subject to a strict governmental control, for example, over a change in the Bank Rate and the amount of note issue.

Like the Reichsbank, the BOJ played a very important role in financing the war economy.

Firstly, the Temporal Fund Adjustment Law (Rinji Shikin-Chosei Ho) of 1937 stipulated that the BOJ's total financial funds be primarily allocated to war-related manufacturing. Banks, forced to finance these firms, participated in loan syndicates in order to share the risks involved. While the Industrial Bank of Japan (IBJ, Nippon Kogyo Ginko) initially organized these loan syndicates, the BOJ took over this task later after the National Financial Control Association (Zenkoku Kinyu Toseikai) was founded and the new BOJ Law was enacted.

Secondly, the BOJ monetized 60-80% of the government bonds, which created a potential source of inflation. The bonds purchased by the BOJ were to be subsequently sold to the public. As far as the central bank succeeded in reselling the bonds in the open market, the government's deficit spending should not have been so much of a worry. In fact, the BOJ, in association with the government, promoted a campaign to increase saving of the private sector in order to resell government bonds. However, the Bank was simultaneously obliged to expand its credit to military industries, through rediscounting commercial bills either accepted by the IBJ and/or guaranteed by the government, and through lending to the Wartime Finance Bank (Senji

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[3] Even the largest surplus of the current account in the 1980s amounted to only ca. 4% to GNP.

[4] How the suspension of the gold standard contributed to the recovery from the depression is described in Iwami, Okazaki and Yoshikawa (1995).

Kinyu Kinko) and the IBJ.[5] According to the wholesale price index of the BOJ (Ohkawa et al., 1967, p. 208), the price of all commodities almost doubled between 1941 and 1945.

After this war-related experience with monetary control, independence of the government became an indispensable part of the whole financial reform.

3. The postwar reform goals and banking reform failures of the Allies

3.1. Germany

The famous controversy within the American administration and with the British over the Morgenthau Plan and over occupation policy in general was sparked already in September 1944, when Treasury Secretary Henry J. Morgenthau, Jr, managed to bring President F.D. Roosevelt to officially endorse his plan to turn postwar Germany into a partitioned and deindustrialized agrarian nation.[6] Within the American administration, three departments were involved in this controversy: the Treasury Department with its Morgenthau Plan, the State Department under Cordell Hull, which favoured a long-term economic and political reintegration of Germany into the community of democratic and peaceful nations, and the War Department under Henry L. Stimson, which demanded a pragmatic approach in occupying Germany that addressed the specific problems of military government there. The final version of the American occupation directive for Germany JCS 1067 was completed and sent to General Eisenhower in mid-May 1945, Truman had succeeded Roosevelt about four weeks earlier and both the State Department and the War Department had regained much of the political influence on German policy that they had lost to Morgenthau, due to his close personal contact with the president, at the summit meeting of Roosevelt and Churchill in Quebec in September 1944. Finally, in early July 1945, Morgenthau resigned in protest over the fact, that he was not appointed to the American delegation attending the Potsdam Conference, which took place from 17 July to 2 August 1945.

JCS 1067 constituted the official foundation for American occupation policy, until a new more constructive occupation directive, JCS 1779, was prepared by General Clay, the head of the American military government in Germany (OMGUS), and was sent to him officially from Washington, D.C., on July 15, 1947, i.e. after the announcement of the Truman Doctrine on March 12, 1947, had marked the beginning of the Cold War. According to JCS 1067 OMGUS was to take no responsibility for stabilizing the German economy. In anticipation of the decisions of the Potsdam Conference, JCS 1067 placed the authority over banking policy in the hands of the Allied Control Council. In practical terms this meant that a banking policy reflecting only American viewpoints could not be executed by the American military government, not even in its

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[5] Teranishi (1993), pp. 158-61, Yoshino (1962), pp. 491-94.
[6] This chapter is based on Holtfrerich (1995), pp. 402-414.

own occupation zone. The Potsdam Agreement represented the second comprehensive agreement of the Americans with the British, following CCS 551 of April 1944, on common guidelines for occupation policy in Germany. It was to be the first and only understanding on occupation directives reached at the tripartite level with the Soviets.

The Potsdam Agreement provided for the decentralization of the political structure, meaning the federalization of Germany, similar to the federal structure of the U.S. At the same time, the Agreement included provisions for „Germany as a whole", for which the Allied Control Council, the new central government for all of Germany, was put in charge. German unity was emphasized especially for the economy: „During the period of occupation Germany shall be treated as a single economic unit." With regard to financial policy, „currency and banking, national taxation and customs" were specifically listed as the areas in which the Control Council was given responsibility to determine a common policy. Yet at the same time a common decentralization policy for the German economy, to be applied also to banking, was agreed upon as an economic pendent to political federalism. It was considered necessary to prevent a concentrated German economy ever to support aggressive militarism in Germany again. „At the earliest practicable date, the German economy shall be decentralized for the purpose of eliminating the present excessive concentration of economic power as exemplified in particular by cartels, syndicates, trusts and other monopolistic arrangements."

The Soviet military government had acted on these principles even before the Potsdam Agreement. Upon taking control of Berlin the Soviets closed all banks „temporarily", which in the case of private banks, including the head offices of the big banks, later turned out to be forever. In Berlin the Reichsbank and its branches were transformed into the new Berlin City Bank (*Berliner Stadtbank*) and as such were permitted to reopen, as were the Savings Bank of Berlin (*Sparkasse der Stadt Berlin*) and its branches. As to the Soviet occupation zone, where the banks had also been closed, the supreme commander of the Soviet military administration, Marshall Shukow, ordered on 23 July 1945 that new banks and savings institutions in public ownership be established on the province, *Länder*, city and communal levels. The Soviets not only decentralized, as their and the American interpretation of the Potsdam Agreement demanded, but they also socialized the banking system, a point on which the Potsdam Agreement was mute and on which the Western Allies disagreed. But it has been argued that the closure of the old credit institutions and the creation of the new ones were motivated less by the ideological aim of quickly nationalizing the economy in the Soviet occupation zone than by a pragmatic goal: by confiscating currency and simultaneously stripping the private bank customers of their claims to currency, the occupation authorities intended to increase the purchasing power of their confiscated Reichsmark holdings and ensure that a greater percentage of the demand for goods and services from German production could be paid for with the newly issued occupation currency, the 'Allied military mark', which was legal tender like the Reichsmark.[7] The Soviets were in a position to issue the occupation currency in unlimited amounts because they had demanded and eventually been given duplicates of the plates.[8] Unlike the Western Allies, they had objected to having the Allied military marks printed solely in Washington, DC, for all four powers starting in the spring of 1944. The complementary effects of this step in 1944 and the closure of the banks in the Soviet zone in 1945 enhanced the ability of the Soviets in the post-war period to place massive demands on the German national product simply, quickly and without any control from their Allies. Since the Soviet Union had suffered the most from the war in comparison with its Allies, and since its zone proved to be the most costly to occupy, the behaviour of the Soviets in the banking issue is understandable from economic and financial perspectives that transcend ideological considerations.[9]

The Soviet side retreated into its ideological shell only after it became increasingly clear in the years to follow that the Western powers were neither going to fulfil the great expectations of the Soviets for resource transfers from Western Germany to both the Soviet zone and the USSR itself, nor willing to pay any price to ensure that Germany was treated as a single economic unit.

The American military government likewise saw the Reichsbank and the big banks to be „excessively concentrated“. By August 1945, it had not yet decided at what level the Reichsbank and the other big banks should be decentralized. When General Clay arrived in Europe in April, he discovered that the Finance Division was being run by Bernard Bernstein, a close colleague of Treasury Secretary Henry Morgenthau. Bernstein had surrounded himself with other colleagues from the Treasury Department in Washington who also favoured the type of Carthaginian peace[10] that Morgenthau envisioned for Germany, or, as the *Wall Street Journal* once criticized, preferred revenge over reconstruction.[11] Throughout America a general debate was ensuing as to whether a policy of repression or rehabilitation could best ensure that Germany remained peaceful in the future.[12] Clay's ambivalent position arose from his evaluation of the directive JCS 1067 shortly after his arrival in Europe: 'We were shocked - not at its punitive provisions but at its failure to grasp the realities of the financial and economic conditions which confronted us.'[13] Clay was speaking not only for himself, but also for his new financial adviser Lewis Douglas, an insurance entrepreneur who also served on the board of directors of General Motors.[14] Douglas labelled the authors of the directive as 'economic idiots' and added: 'It makes no sense to forbid the most

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[7] Deckers (1974), pp. 26-7. The Americans estimated the monthly issue of military notes by the Soviets in 1945 to be 1 billion RM. See Gottlieb (1956/57), pp. 398-417.
[8] Ziemke (1975), p. 60
[9] Deckers (1974), pp. 25-7.
[10] Clay (1950), p. 19.
[11] Schwarz (1980), p. 99.
[12] Gaddis (1972), p. 96.
[13] Clay (1950), p. 18.
[14] Horstmann (1991), p. 54.

skilled workers in Europe from producing as much as they can for a continent which is desperately short of everything.'[15] Clay appointed Douglas as Bernstein's supervisor and then sent Douglas back to Washington immediately, where he was able to have several smaller modifications made to the directive by early May. Two months later, however, Douglas resigned out of frustration with the final version of JCS 1067.

Like the entire community of American big business, the two other top advisers Clay had brought with him from America were vehemently opposed to the Morgenthau policy: William H. Draper from the banking establishment Dillon, Read & Co., New York, as economic adviser, and Robert Murphy from the State Department as political adviser. These two men used what leeway for interpretation there was to make constructive use of the occupation directive. Draper later went to Japan to apply recipes for industrial transformation similar to Germany.[16] In October 1945, 'Morgenthau's man' Bernstein resigned from the military government after Clay had stripped him of much of his authority by making Bernstein chief of the new 'Division of Investigation of Cartels and External Assets' and by appointing a man of Clay's choice from Washington to succeed Douglas in heading the Finance Division in September 1945. This new top adviser was the respected banker Joseph M. Dodge, chairman of the board of Detroit Bank and Trust Co. and president of the American Bankers Association. He was also sent to Japan later on. Until he was succeeded in Germany by his deputy Jack Bennett on 1 June 1946, Dodge was the decisive American for conceptualizing the reorganization of the banking business, currency relations and financial structures in West Germany.

Starting in June 1945, before Douglas left his post, the financial experts in the American military government were divided into two camps, each camp supporting a different plan for the decentralization of the Reichsbank and the big banks. The plan that best concurred with Douglas' own ideas called for a decentralization of the Reichsbank at the level of the occupation zones. The Reichsbank chief office in Frankfurt was to become the central bank of the American zone and to assume the supervision of the banks in the entire US zone. The second plan mirrored Bernstein's vision of decentralization on a *Land* basis in conjunction with the American plans for creating a federal, *Land*-oriented political order in Germany.[17] In both cases, the decentralization of the big banks was not stated explicitly, but the practical application of these plans to big banks was implied by analogy of the situation.

Following the agreement in Potsdam, the financial experts from the American military government even developed plans that provided for a central bank for all of the zones, and for the continued existence of the big banks with new head offices to replace the closed ones in Berlin. Such plans corresponded to their interpretation of the commitment made at Potsdam to treat Germany as a single economic unit,

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[15] Murphy (1964), p. 308.
[16] Berghahn (1995), p. 71.
[17] Horstmann (1991), pp. 58-9.

especially in the areas of currency and banking. In their opinion, they also facilitated greater economic and administrative efficiency.[18]

Shortly after he took office, in late September 1945, Dodge chose the plan he preferred. Surprisingly, the plan he chose was the one based on Bernstein's concept of decentralizing the banking system at the *Länder* level, while his staff favoured the model of zonal decentralization.[19] At most, he was willing to concede the creation of an inter-*Länder* Bank Council that would co-ordinate the Land Central Banks in the American zone. Dodge was determined to subordinate the creation of a new banking system to the same political goals of federalization decided upon at Potsdam. Another influence on Dodge's decision was the 'home model': in the United States banking was decentralized at the level of the individual states, except for the US Federal Reserve System. It operated on the basis of 12 Federal Reserve banks, each in districts superimposed on the state banking system.[20] Dodge was also borrowing from this 'home model' when he proposed to dismantle the universal banking system in favour of a division of labour among banks, so to speak, in which banks would do business either in long-term securities (investment banks), or in short-term deposits and credit (commercial banks). He also wanted to ban the use of supervisory board positions to interlock industrial and banking directorates.

The Dodge Plan provided for the decentralization of the German banking system and of bank supervision to the *Land* level „in order to destroy the financial monopoly of the Reichsbank and the big banks". A central bank was to be established in each of the federal states. These were not the legal successors of the old Reichsbank, whose head office, like those of the big banks, in Berlin had been closed by the Soviet occupation authorities, but they were authorized to take over the Reichsbank's assets and liabilities in each respective *Land*. They were not authorized to issue currency, but entitled to regulate the existing currency and credit in each *Land*. They were designed to serve as reserve centers and as lender of last resort for the commercial banks and savings institutions. They were to function as bankers' bank and as the fiscal agent for the respective *Land* government. In contrast to the Reichsbank they would not be permitted to do business with the non-bank private sector. They had to provide for clearing arrangements with the other central banks. The big banks were to be decentralized

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[18] National Archives, Washington, D.C. (NA), RG 260 (OMGUS), FINAD. Records Relating to Financial Institution Policy 1945-49, Box 153, Folder: Potsdam Agreement. Memorandum dated 5 September 1945, 'Implementation of the Potsdam Agreement' by Major E.C. Ophuls, Financial Institution Section of the Financial Branch, G-5 Division, USFET. The three concepts for restructuring the German banking system mentioned here were also noted in a historical report on 'Financial Institutions - SHAEF Period' from 29 August 1945. NA, RG 260 (OMGUS), FINAD. Records Relating to Financial Institution Policy 1945-1949, Box 131, Folder: Administration of Military Government in the US Zone in Germany, July 1945.

[19] Horstmann (1991), pp. 61-2.

[20] For more on the impact of the 'home model' on American banking policy in Germany, see Loehr (1952), pp. 124-6.

accordingly. The Reichsbank and the central offices of the big banks were to be legally eliminated.[21]

In late October 1945 Joseph Dodge submitted his decentralization plan to the Allied Control Council for discussion in its Finance Directorate. It was taken up on November 6, 1945. Only the British opposed the American proposals.

They considered an efficient, even centralized banking system to be the prerequisite for a rapid revival of the German economy. The British zone was dependent on this much more than were the Soviet, American or French zones. The Ruhr valley was the industrial heart of Europe, and the recommencement of coal shipments was considered essential for the revival of industry in the neighbouring countries as well. It was for this reason that the British national budget had been burdened after the end of the war with large subsidies which were needed just to commence the mining of Ruhr coal again. The British zone was also the most densely populated and therefore least able to feed itself. So another heavily burdening cost to the British national budget was the food it imported into its occupation zone.[22] There was only one solution to this dilemma for financially crippled Great Britain: the German economy had to be revived to the extent that its industrial exports earned the foreign currency needed to finance the importation of foodstuffs and the subsidization of coal mining as long as coal prices were regulated.

There was another factor influencing British banking policy. The British banking system itself was similar to the German one in that its structures were also centralized, within both the central bank and the commercial banking system. The British system was similar to the American banking structure only in that commercial banks were separate from investment banks. Therefore, in contrast to the Soviets, the Americans and finally even the French, the British refrained from morally condemning a centralized banking system as having been the support system of the National Socialist war machine.

The liabilities of German banks to the British that had arisen from the Standstill Agreements of the inter-war period provided another strong motive for the British desire to retain as centralized a banking structure as possible in Germany.

The British member of the Finance Directorate, S.P. Chambers, argued against the Dodge Plan by pointing out that a unified central banking and banking system would be more efficient and would correspond to the Potsdam Agreement to treat Germany as a single economic unit. Furthermore, a system of big banks with a network of branch operations could not evolve into a dangerous concentration of economic power if controlled by the military governments. On the contrary, a centralized banking system would aid the Allies in implementing their plans for monetary and credit policy. Such a system

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[21] Loehr (1952), pp. 9-11.

[22] In 1946, exports from the British zone earned a total of $ 145 million, as opposed to $ 350 million spent on imported goods, of which $ 291 million went for the importation of food alone. Historical Archive of the Deutsche Bundesbank (HADBB), Monatsberichte der Reichsbankleitstelle Hamburg, No. 11 (for April 1947).

would be less susceptible to crisis and would prevent any possibility of creating local monopolies.

While the Americans were preparing the implementation of their decentralization proposals in their own occupation zone, the British acted in the opposite direction. After the British military government had officially ordered, in September 1945, the big banks to establish a directing office in Hamburg for their banking operations in the British occupation zone as a whole, which the Deutsche Bank and the Commerzbank had already done, it ordered, on November 24, 1945, that a Reichsbank chief office for the British zone, i.e. for several states, be set up in the existing branch office of the Reichsbank in Hamburg. In contrast, in mid-December 1945, the American military government instructed the *Länder* governments in its zone to prepare to set up Land Central Banks.

Discussions in the Finance Directorate of the Allied Control Council continued to meet with British opposition. By April 1946, Dodge felt compelled to propose a compromise in order to find a solution to the stand-off that had developed. He proposed establishing a Länder Union Bank that would act as a central bank for all four zones placed above the Land Central Banks. This bank would co-ordinate the measures needed to treat Germany as a single economic unit, namely the fundamental decisions in monetary and credit policy, and the balancing of the financial requirements of the German economy: that is, the savings-investment relations between surplus and deficit areas, reparations, foreign trade and reconstruction. The organization of the bank would also be mirrored by its functions: it was proposed to create a department for issuing bank notes, a separate one for the usual banking business, a department of reconstruction finance, and one for exports and imports.[23]

The British reacted favourably to this concession by agreeing to the decentralization of the big banks and bank supervision on a *Land* basis, to the creation of Land Central Banks in place of the Reichsbank, and to the liquidation of the head offices of the big banks and the Reichsbank in Berlin. Now the Soviets and the French rejected the idea of a Länder Union Bank because they felt it would be a far too centralized institution; yet the British refused to back down on their demand for the creation of some sort of suprazonal institution such as the Länder Union Bank.

Before Dodge resigned and his colleague Jack Bennett took over the Finance Division in June 1946 (until May 1949), Dodge proposed yet another compromise in May, featuring a 12-member Länder Central Bank Commission, which would compromise three Land Central Bank presidents from each zone who would be appointed by the respective military governments. All decisions made by this commission were first

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[23] NA, RG 260 (OMGUS), FINAD. Records Relating to Financial Institution Policy 1945-1949, Box 135, Folder: Banking Committee - Elimination of Excessive Concentration of Economic Power in Banking. DFIN/P(46)39, 5 April 1946, Paper Submitted by US Member: 'Proposal for a New Länder Union Bank'. Also located in Bank of England Archive (BEA), OV 34/11.

to be approved by an Allied Banking Board, which would be made up of one representative each from the four military governments.

This proposal became the basis for an agreement in the Banking Committee of the Finance Directorate on 21 June 1946, to decentralize the banks on a *Land* basis, including the liquidation of the Reichsbank and the big banks' head offices in Berlin.[24] Yet a month later, as the Finance Directorate itself met to deliberate the plan proposed by its Banking Committee, only the three Western powers were still willing to agree to it. At the meeting held on 24 July 1946, the Soviets now rejected this proposal because it would not truly break up the power of the German 'monopolies' in the banking sector. Instead, they recommended a solution that corresponded to the practice in the Soviet zone, where - except for the co-operatives - the only credit institutions still permitted to operate were state owned.

As a result, the issue of socialization was introduced into the talks alongside that of decentralization. The inflexibility of the Soviet position in the negotiations was certainly related to the failure of the second conference of the Council of Foreign Ministers in Paris on 12 July 1946; this council had been created by the Potsdam Agreement. The other factor was the concurrent announcement of the US Secretary of State, James F. Byrnes, that if it became necessary to consolidate the zones in order to administer them as a single economic unit, this step would be taken - and indeed the USA and Great Britain did agree on 5 September 1946 to create what would become the Bi-Zone.[25] After the Soviets refused to treat Germany as an economic unit according to the Anglo-American interpretation of the agreement reached in Potsdam, and after they then proved only to be interested in free reparation transfers from the Western zones, Clay had all such transfers from the US zone to the USSR stopped in early May 1946.[26]

Due to the irreconcilable differences that had arisen in the Finance Directorate, the policy decision was handed up to the Coordinating Committee,[27] the next highest political authority at the four-power level; from there it was finally passed on to the Allied Control Council itself, where all attempts to arrive at an agreement among the Allies finally

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[24] The paper that the representatives of the four powers agreed upon is filed under the reference number DFIN/BC/MEMO(46)15. It is located in NA, RG 260 (OMGUS), FINAD. Records Relating to Financial Institution Policy 1945-1949, Box 135, Folder: Banking Committee - Elimination of Excessive Concentration of Economic Power in Banking. See also the minutes of the meeting of the Finance Directorate on 24 July 1946, ibid., Box 144, Folder: Elimination of Power of Banks, etc. A reconstruction of the events and all of the important documents can also be found in BEA, OV 34/11 and 34/12.

[25] Weber and Jahn (1973), pp. 15-18.

[26] Latour and Vogelsang (1973), pp. 158-60; Krieger (1987), pp. 139-43.

[27] The papers presented to this committee contained the proposals unanimously passed by the Banking Committee and a notation of the differences that arose in the Finance Directorate. See NA, RG 260 (OMGUS), Allied Control Authority, Finance Directorate (DFIN), Box 342, specifically DFIN/Memo(46)161, 30 September 1946, with DFIN/Memo(46)130 (2nd Revise) as supplement [identical with DFIN/BC/MEMO(46)15].

failed on 21 October 1946.[28] As a result, the job of restructuring the banking system once again reverted to the commanders-in-chief of the respective zones.

3.2. Japan

In accordance with the occupation policy in Germany, General Douglas MacArthur, the Supreme Commander of the Allied Powers (SCAP[29]), aimed at reforming the Japanese economy with objectives of "demilitarization and democratization" which would not allow the military capabilities to be reconstructed. An important difference from the German case lies in the fact that Japan was actually occupied by the United States alone, despite the name of the "Allied Powers," and that the Occupation Powers did not directly govern, but only indirectly control the policies of the Japanese government. In other words, the Japanese side maintained a limited degree of freedom to resist to orders by the SCAP.

The postwar economic reforms included the break-up of such "feudalistic" systems as *Zaibatsu* conglomerates and the landowner-tenant relationship, on the one hand, and the creation of democratically legitimized trade unions and collective wage bargaining, on the other hand. The reformists within the Economic and Scientific Section (ESS) of the SCAP worked on the assumption that the shortage of effective demand within prewar Japan had led to the aggressive Japanese drive for export markets coupled with growing militarism. When the reform policy would bear fruit, private domestic consumption would be expected to rise and lead to growth and employment. But officially, the US side did not regard it as its responsibility to repair and stabilize the Japanese economy.

However, when the East-West confrontation had developed momentum and had eventually led to the Cold War as symbolized in East Asia by the foundation of the People's Republic of China in 1949, the aim of the occupation policy turned to the reconstruction of the Japanese economy. This would reduce the expenses of the economic assistance program called GARIOA (Government Account for Relief in Occupied Area) and EROA (Economic Rehabilitation Account in Occupied Area), and hence the burden on the US tax-payers, on the one hand, and would also secure the material basis for the US military engagement in East Asia, on the other hand. Already in October 1947, the SCAP made a report on the "Possibility of a Balanced Japanese Economy", and in November 1948, its revised version, "Program for a Self-Supporting Japanese Economy", was published. In December 1948, following up these requests from Tokyo, Washington ordered the 9 principles for the economic stabilization.[30]

The 9 principles included a balanced budget with expenditure cuts and increased taxes; deficit financing restricted to reconstruction;

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[28] These failed attempts at reaching a common banking policy are described in detail in Appendix B of DFIN/BC/MEMO(47)1 'Subject: Banking', in BEA, OV 34/13.

[29] The abbreviation, SCAP, is used below as the central organ of the Occupation Powers, which was also called GHQ (General Headquarters).

[30] For the general trend of the occupation policy, see Nakamura (1979).

stabilization of prices and wages; control on foreign exchange and trade; promotion of industrial production and exports; efficient food allocation. These principles reflected a compromise between the interventionists, in other words "New Dealers," in Tokyo and conservative liberalists in Washington. The latter finally gained the upper hand in shaping Japanese economic policy after, in 1949, President Truman sent Joseph Dodge, a bank president from Detroit, as a fiscal and monetary adviser to the SCAP.

Recently economists of the younger generation tend to stress the continuity from the war economy rather than the discontinuity brought about by the economic reforms during the occupation.[31] Although it is out of the scope of this chapter to assess the new interpretation of the postwar economic history in Japan as a whole, the financial sector is a good example to support the argument above, as the following section reveals.

With a view to the financial institutions' active participation in the Japanese war economy, the SCAP naturally intended to implement radical reforms of the financial system. As early as September 1945, the most fundamental measure of postwar financial reforms took place: removing central and colonial banks in former colonies, Taiwan and Korea, as well as those institutions specialized in war finance, the Wartime Finance Bank for example. Other financial institutions engaged in more or less nationalistic objectives were either removed or reformed. In December 1946, the Yokohama Specie Bank, specialized in international finance, was closed and eventually transformed into a private foreign exchange bank, the Bank of Tokyo, because the former bank had extended its business into issuing military scrip in the occupied territories and financing military operations in China.

The big banks within the four *Zaibatsu* concerns (Mitsui, Mitsubishi, Sumitomo and Yasuda) became targets of economic democratization and antitrust policy, as the report of the State-War Mission (March 1946) clearly stated. It is important to note, however, that while the *Zaibatsu* conglomerates were partly broken up, the leading banks within the *Zaibatsu* concerns were not partitioned.[32]

After the compensation payments for wartime financing were terminated in the second half of 1946, those banks which had lent to military industries recorded large-scale bad loans. Most financial institutions were too weak to accept radical restructuring. The BOJ was also opposed to the break-up of the big banks on the grounds that such a measure would disturb the reconstruction of the economy.[33] SCAP determined, shortly after the Antitrust Committee issued the final report in July 1948, that the Antitrust Law (the Law against Excessive Concentration of Economic Power) would not be applied to the banks.

Up to 1948, the SCAP did not announce clear ideas on financial reform in Japan. There was only a discussion of breaking up the big banks. It lasted until March 1948 that Clifford E. Cagle, senior analyst of the Federal Reserve Board (FRB) sent as an adviser for the ESS,

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[31] Teranishi and Kosai (1993) and Okazaki and Okuno (1993).
[32] Tsutsui (1988), pp. 42 ff. For the financial reform as whole, see Kato (1974), Tsutsui (1988) and MOF(1976, 1983).
[33] BOJ (1985), p. 283.

proposed to the ESS Finance Division an overall banking legislation. This proposal was drafted, in a sense, in order to stand against the idea of breaking up the big banks, which had been advocated by the Antitrust and Cartel Division. The essence of this memorandum was repeated again in May and proposed as a New Banking Law in August of the same year. The new law included the idea of a Banking Board, which will be discussed in the next section.

Following the principle of this law, SCAP advised the Ministry of Finance (MOF) to close semi-public banks specialized in long-term business. For the administrators from the United States, where banks engaged in short-term business and the long-term credit was left to the capital market, those "special banks" issuing finance bonds and providing long-term credit were hard to accept. In addition, their activities within the war economy, in particular the case of the IBJ, had been examined with critical eyes.

The IBJ, Hypothec Bank of Japan (Nippon Kangyo Ginko), and the Hokkaido Colonial Bank were subsequently all privatized, but allowed to exist. The Hypothec Bank and the Hokkaido Colonial Bank were re-chartered in 1948 as "ordinary" commercial banks, while the IBJ retained its privilege to issue finance bonds and later reorganized as a most powerful, private institution for long-term credit.

As the US reform plan was initially aimed at the "democratization" of the economy, little attention was paid to an efficient working of the financial system. The American principle of commercial banking, coupled with long-term fund-raising in the capital market, did not take account of the situation in which the postwar Japanese financial system was located. Due to the runaway inflation, private financial assets had lost their real value almost completely, and hence, the capital market operated far from its normal capacity under stable conditions.

Although the SCAP initially stood firmly against specialized public financial institutions, long-term credit for capital accumulation could not be provided by private banks alone. Therefore, public financial institutions were established such as the Export Bank of Japan (December 1950) and the Development Bank of Japan (March 1951). Moreover, the Long-term Bank Law (June 1952) legalized the business of private banks for long-term credit.

Japan's financial sector was largely shielded from the main stream of postwar economic reforms, because firstly, the Japanese side (both the government and the financial industry) resisted strongly to proposal from the US side, and secondly, the SCAP came around to prefer the efficient reconstruction of the Japanese economy to the original "democratic" reform ideas, in particular after the Chinese communists took power in 1949.

4. Results of central banking and currency reforms and of monetary policy performance

4.1. West Germany

Parallel to his suprazonal banking decentralization proposals to the Allied Control Council, Dodge had ordered the *Länder* in the US zone in mid-December 1945 to pass their own legislation to decentralize not only the big banks, but also the Reichsbank by establishing Land Central Banks. While the decentralization of the big banks was resisted not only by the banks themselves, but by almost all the German politicians involved, the *Länder* of the US zone came to cooperate with OMGUS on the Land Central Bank issue. They recognized that their political influence would grow once Land Central Banks had been established at the expense of the Reichsbank. After the failure of an agreement on a common banking policy in the Allied Control Council in October 1946 and before the *Länder* in the US zone were equipped with parliaments in late 1946, which would have had to deliberate a law on Land Central Banks, each of the *Land* governments issued an identical Land Central Bank law at the request of OMGUS. The Land Central Banks in the US zone were thus opened for business in early 1947. The French military government followed suit and issued „Ordinance No. 78 on the Liquidation of the Reichsbank and the Establishment of Land Central Banks" on 18 February 1947, in which the *Länder* of the French zone were required to establish these institutions by March 1, 1947.

The British, however, resisted the American decentralization policy again. Even before OMGUS issued Military Government Law No. 57 on May 5, 1947, to override German resistance and order the decentralization of the big banks in addition to the Reichsbank in the US zone, Charles A. Gunston, the expert on Germany at the Bank of England, was pleased to note January 17, 1947, that the British military government had not also implemented this „lunatic idea of the American Dodge".[34] For a long time, the British did not give in to the pressure by OMGUS to decentralize banking in the British zone. They were on the side of the almost unanimous German opinion on this issue. The American decentralization scheme for the big banks was evaluated as being completely unsuitable for the German system of banking, as was emphasized in reports submitted on 27 November 1946, and again on 29-30 April 1947, by the finance committee of the Zonenbeirat (Zonal Advisory Council), a body of German citizens appointed by the British military government.

Although in principle the British Finance Division shared this view fully, in practice it wanted to remain politically more flexible in dealing with the Americans. This was necessary since both the agreement on the founding of the Bizone of 5 September 1946 and the Potsdam Agreement had explicitly specified finance, and thus the banking system, as one of the political areas in which the policy of the occupation powers was to be uniform. The banking issue was deliberated in a banking subcommittee of the Bipartite Finance Committee/Panel, which was composed of the heads of the Finance Divisions in the British and American military governments, and to which was also assigned a Gemeinsamer deutscher Finanzrat (Joint German Council on Finance) with its subcommittee, 'Money and Credit'.

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[34] Memorandum by C. Gunston of January 17, 1947 „Reichsbank chief office in Hamburg", Bank of England Archive (BEA), OV 34/13.

In return for their willingness to federalize the Reichsbank structure and to decentralize the big banks in their zone accordingly, the British not only demanded a bizonal budget, which would commit the Americans to sharing the heavy financial burden of subsidizing the British zone, but also asked that a type of bizonal central bank be established in order to centrally direct monetary and credit policy. The British had been advocating such a central bank for quite some time in the negotiations on the institutional framework of the Bizone since October 1946. Following the announcement of the Marshall Plan in June 1947, they also wanted American co-operation in establishing a Reconstruction Loan Corporation for the purpose of financing industrial reconstruction, especially in the Ruhr region, through long-term credit from outside their zone.

Sir Eric Coates, who succeeded Chambers as head of the finance Division in June 1947, presented this package of demands to his American counterpart, Jack Bennett, in late August 1947, nearly six weeks after the American decentralization policy, also for banking, had been explicitly spelled out in the new occupation directive JCS 1779 issued by Washington on 15 July 1947. Although this directive acknowledged more than its predecessors the necessity of making reconstruction a priority over revenge, the British pushed for more. Bennett, whom the British did not think highly of and considered obstinate and doctrinaire,[35] balked at the idea of creating a bizonal institution with the functions of a central bank. At most he was willing to concede the setting up of a co-ordination office above the Land Central Banks of the Bizone, so that the responsibility and decision-making power in monetary and credit policy would actually remain decentralized at the *Länder* level.

However, Clay wished to reach a compromise with the British quickly and was now convinced himself that a central bank was a prerequisite to bringing urgently needed economic stabilization to the Bizone. On 16 September 1947, he took up the matter with Washington,[36] and on 3 October 1947, he received the go-ahead to set up a central bank, the Länder Union Bank. This model of the Bank deutscher Länder had already been under discussion at the four-power level. The 'doctrinaire' Jack Bennett was forced to relent.

The British now convinced the Americans that a bizonal central bank should be headed by a board of managers with a president or general managing director. From this would later evolve the Directorate of the Bank deutscher Länder. The board of managers was to carry out the decisions on monetary and credit policy made by the board of directors, the later Central Bank Council (Zentralbankrat). This body was composed exclusively of the presidents of the Land Central Banks, as the Americans had originally proposed, and functioned independently of any instructions by the governments, similar to the Board of Governors of the Federal Reserve System and unlike the Bank of England since 1945.

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[35] Ibid., p. 134. For more on the British arguments in the controversy with the US military government during the establishment of the Bank deutscher Länder, see BEA, OB 34/90.

[36] Telegram quoted in Smith (1974) pp. 429-31.

The Bank deutscher Länder was established on 1 March 1948, by both military governments of the Bizone.[37] The new legal residence of the bank became Frankfurt. At the same time, the Allied Bank Commission was also formed, comprising the heads of the finance divisions of the military governments and later of the High Commissioners. This new commission had veto power over the decisions made by the bodies of the Bank deutscher Länder.[38] France, which wanted to support currency reform in the three Western zones, integrated its three Land Central Banks into the new central bank and joined the Allied Bank Commission by issuing Ordinance No. 155a of the French military government on 19 June 1948, retroactively to 25 March 1948. The founding of this central bank made it possible to implement currency reform in the Western zones on 20 June 1948.

The further demand of the British for a suprazonal reconstruction credit institution was also accepted by the Americans. But it was only after the currency reform that several drafts for legislation were drawn up in the Bizonal Finance Administration and the Economic Administration. The final version became the Reconstruction Loan Corporation Act (*Gesetz über die Kreditanstalt für Wiederaufbau*) and went into effect on November, 5, 1948.

Currency reform and monetary policy performance

Once the Bank deutscher Länder had been founded and the French zone had been retroactively integrated on 19 June 1948 into the British-American agreement concerning this bank, everything was set for the long-discussed and well-planned currency reform in the three Western zones. The very next day, on 20 June 1948, the three Western military governments enacted identical legislation for the immediate introduction of the currency reform so long awaited by the population and business. The Western Allies had attempted one last time in early 1948 to implement such reform in conjunction with the Soviets, but these efforts had failed.[39] This came as no surprise to C.A. Gunston, who had commented on 15 January 1948 that the government experts in London were all aware that quadripartite currency reform was not realistic. "The problem is how to offer it to the Russians in such a way that the Russians will reject it without putting us in the wrong."[40]

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[37] Law No. 60 of the American military government and Ordinance No. 129 of the British. For the history leading up to its founding, see Horstmann (1990), pp. 202-18. Horstmann (1989), pp. 135-54.

[38] Wandel (1980), p. 81. A more detailed account of the policies of the Allied Bank Commission can be found in Loehr (1952), pp. 21-40.

[39] The reasons for this are presented in Graml (1985), pp. 203-7. Brackmann (1993), pp. 239-43.

[40] Memorandum from Gunston 'Germany: Financial Reform', 15 January 1948, to Sir O.E. Niemeyer and Mr Siepmann, BEA, OV 34/19. This file contains other interesting details on the preparation phase of currency reform. See also Möller (1961), and Möller (1976), pp. 433-83. For the more recent discussion on the political impact of currency reform on stability and growth and on the significant German contribution to shaping this reform, see numerous articles by C. Buchheim and R. Klump, including those in Fischer (1989), pp. 391-422. Klump (1989). Brackmann (1993). Several documents showing the influence of German experts on shaping currency reform, e.g. the final report of the 'Konklave im Rothwesten' and two memoranda of Central Bank Council President Bernard about meetings with the military governors, are located in

The Soviets reacted to the currency reform in the West by implementing their own currency reform in the Soviet occupation zone and all of Berlin three days later, on 23 June 1948. They first introduced a makeshift currency known as the coupon mark or *Klebemark*; due to the lack of new bills, coupons were simply glued on to the old Reichsmark, devaluing these at a ratio of 10:1 in East German marks. Every individual could exchange up to 70 RM into the new currency at a ratio of 1:1. Savings deposits in savings banks and other institutions were exchanged at the rate of 1:1 for the first 100 RM; at a ratio of 5:1 for the next 900 RM; and at 1:10 for amounts above this and for any other bank liabilities and debts.

This step forced the three Western sectors of Berlin to introduce a day later the new Deutsche Mark, the currency in circulation in the Western occupation zones, so that the city would not lose its economic connections to the Western zones, or sacrifice its economic and political future to the Soviets.[41] Because so many people still travelled back and forth between East and West Berlin, the East German mark continued to be treated as legal tender to a limited extent in the Western sectors of Berlin at an exchange rate of 1:1 with the Deutsche Mark until 20 March 1949, but only for items under price control, such as foodstuffs and rent, for taxes and other fiscal charges, as well as for fees for postal services, public transportation, electricity and gas. Otherwise, the rate of exchange for the new East German currency sank quickly against the Deutsche Mark in the following months to a rate of 4:1.

These developments sealed the fate of Germany as a partitioned land, at least as far as currency was concerned. The Soviets immediately reacted to the currency reform in West Berlin by blockading all access routes (streets and waterways) and by cutting off the electrical supply to West Berlin. Not until the airlift to West Berlin had gone on long enough to convince the Soviets that the Allies were determined to support West Berlin and its connections to the West did they end this blockade on 12 May 1949. The Soviets also reacted to the currency reform introduced in West Berlin by leaving the Kommandatura, the four-power administration governing the city, on 1 July 1948. After this, the political tensions within the joint municipal administration of Greater Berlin grew worse. Municipal elections could only be held in the Western sectors in December 1948. The new City Assembly for the Western sectors elected Ernst Reuter as mayor. By then the municipal administration had already been partitioned, and it had been decided to establish the Free University in West Berlin in September 1948 as a result of the Communist interference in the freedom of research and teaching at the traditional Humboldt University in East Berlin.

On 20 June 1948, two laws were enacted in the Western zones, the Currency Act and the Currency Issue Act. The former legislation defined the new legal tender, the Deutsche Mark, regulated the process of turning in and registering the old currency, and stipulated the initial

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(Historisches Archiv der Deutschen Bank, Frankfurt/M.) HADB, file: Währungsreform 1948. More on currency reform in (HADB), RWB, 7.

[41] See Wolff (1991).

allotment for individuals (*Kopfgeld*), businesses (*Geschäftsbeträge*) and the public sector. Individuals received 40 DM per head at first and were permitted to exchange another 20 DM at a rate of 1:1 two months later. Businesses were equipped with 60 DM per employed person. Public sector institutions received funds in DM which in principle amounted to the prospective outlays for one month, while the German railways and postal service was allotted half a month's outlays. Although the original intent had been to link currency reform immediately to an equalization of war burdens, so imperative for social reasons, this was not done. It was merely stipulated in the preamble of the Currency Act that German legislative bodies were 'assigned the pressing task of regulating the equalization of war burdens by 31 December 1948'.[42] However, provisional legislation was not enacted until August 1949 and the final Equalization of War Burdens Act not until July 1952.

In the Currency Issue Act, the issue of bank notes and coins was regulated through the Bank deutscher Länder. For the first time a German central bank was delegated authority in determining minimum reserve requirements. The most important legislation in the currency reform package was the Currency Conversion Act of 27 June 1949, and the numerous ordinances issued afterwards to implement it. In order to reduce the excess money supply that had resulted from financing the war, and thereby make the level of prices set by control correspond to fair market prices, monetary assets were generally converted at a rate of 1 DM for 10 RM. To prevent prices from plummeting, a conversion ratio of 1:1 was set for regularly recurring obligations, such as wages and salaries, rental payments and retirement pensions, as well as liabilities resulting from purchase and work contracts, from disputes between companies, and in family matters and inheritance cases.

As it was, deposits at banks (including savings banks), into which cash had to be placed in order to be converted, had an even lower rate than the 10 per cent prescribed for other financial assets. All Reichsmark liabilities between banks were cancelled, declared void. Deposits of non-banks were credited at a rate of 1 DM for 10 RM, but the depositor only had free access to half of this; the other half was deposited in a blocked account, known as a *Festkonto*. On 4 October 1948, both the Fourth Currency Reform Act (*Viertes Gesetz zur Neuordnung des Geldwesens*) in the Bizone and the corresponding ordinance of the military government in the French zone went into effect. These stipulated that 70 per cent of the deposits on each *Festkonto* were to be voided, 10 per cent were to be transferred into medium-term and long-term securities, and 20 per cent were to be released. Thus only 6 per cent of Reichsmark cash and deposits at the banks were directly accessible in Deutsche Marks, and 93.5 per cent of the Reichsmark deposits were lost completely.[43]

This discrimination against liquid assets in the form of cash and bank deposits resulted in part from the disproportionate losses which banks

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[42] Langen (1948), p. 5. The technical details of currency reform are to be found here and also in Stucken (1964), pp. 201-8.
[43] On the discussion within the Allied Bank Commission about these quotas, see Loehr (1952), pp. 24-6.

(and insurance companies) incurred because one stipulation of the Currency Conversion Act declared the liabilities of the Reich, including the Reichsbahn (State Railways), the Reichspost (Postal Service) and the Reichsbank, to be null and void (para. 14). Since these outstanding debts of the Reich represented the major portion of the assets of credit institutions (and insurances), these financial businesses would have gone bankrupt had they not been granted somewhat equivalent financial relief. On the liabilities side of their balance sheet, relief came in the form of the reduced conversion rate of 6.5 per cent mentioned above. On the assets side these financial businesses also received some compensation: 15 per cent of their Deutsche Mark demand deposits and 7.5 per cent of their savings and time deposits were credited to them on giro accounts by the Land Central Banks. The Land Central Banks also credited them the full amount of the *Geschäftsbeträge*, i.e. the initial allotment in Deutsche Marks that the banks had payed out or credited to businesses.

If these credited funds and their other assets were still not sufficient to secure a 'suitable equity capital' and cover the converted liabilities, the banks were granted equalization claims against the public sector at 3 per cent interest from the *Länder*. However, para. 28 of the Currency Conversion Act prohibited budget deficits in the public sector. In order not to overburden the public sector from the very start with debts incurred through such equalization claims, a significant proportion of the losses suffered by the banks as a result of the nullification of Reich debts was passed on specifically to the depositors at the banks by granting a currency conversion rate of only 6.5 per cent at most instead of the normal 10 per cent.

The Fourth Currency Reform Act of 4 October 1948 must also be considered in connection with the inflationary trends that followed currency reform. These trends were easier to spot than those of the earlier period of suppressed inflation because Ludwig Erhard, who was at the time director of the Economics Administration and later became Federal Economics Minister, ordered the decontrol of prices in tandem with an end to rationing on most markets. Erhard had been given the authority to take such action by the Bizonal parliament, comprising of the Economic Council and the Länderrat, in the *Gesetz über Leitsätze für die Bewirtschaftung und Preispolitik nach der Geldreform* (Act on Guidelines for Rationing and Price Policy following Currency Reform) passed on 24 June 1948.

The price increases that occurred during that summer may therefore have been an important reason why, on 4 October 1948, the military governments passed the Fourth Currency Reform Act, which greatly diminished the purchasing power on the *Festkontos* of the banks. In order to combat inflation further, the Bizonal administration prohibited profiteering by enacting laws that went into effect on 7 October 1948 and 28 January 1949.[44] In late October 1948, the Bank deutscher Länder placed restrictions on credit, which were gradually lifted once prices began to stabilize in late May 1949. In the meantime, wage controls had been lifted by law on 3 November 1948. The fact that aid

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[44] Stucken (1964), p. 209.

from the Marshall Plan began during this critical period helped stabilize the situation.[45]

Decisions made in connection with currency reform also simplified foreign business relations. On 1 May 1948, the exchange rate for 1 RM was uniformly set at 0.30 US dollars. Subsequently this rate was also valid for the Deutsche Mark. Step by step, this exchange rate replaced a multitude of differing settlement rates in foreign trade that had been used by the Joint Foreign Exchange Agency (JFEA) and the Joint Export-Import Agency (JEIA) of the Bizone.[46] Due to the dollar gap, foreign exchange controls had to be continued, of course.[47]

4.2. Japan

The SCAP initially regarded the BOJ as a focus of the financial reform, due to its central role in financing the war. Even before Japan finally surrendered to the Allied Powers, the US War Department prepared guidelines for the "Control and Use of the Bank of Japan" (August 1945). They included proposals such as to dismiss members of the executive board, issue new "yen" and suspend the use of the foreign exchange reserves. These guidelines actually influenced the subsequent policy to a certain extent.[48]

However, in October 1945, the Japanese government took an initiative to set up a provisional committee for reforming the BOJ, with an intention to avoid the intervention of the SCAP. According to the BOJ (1985, p. 268), the central bank insisted within this committee on its neutrality and independence of the government, which the MOF eventually did not like to accept. Subsequently, the first Council of the Financial Institutions (CFI: Kinyu Seido Chosakai) under the MOF proposed a plan in January 1946, largely similar to the above committee, to reform the BOJ and establish the Finance Agency (Kinyucho). This Agency, to be managed jointly by the MOF and BOJ, was supposed to deal with the national financial needs and to control the fund allocation as a whole. In November 1947, the second CFI proposed instead a Currency and Credit Committee. It was to design and conduct an overall monetary and credit policy, with a membership of the BOJ Governor, two Ministers of both Finance and the Economic Stabilization Agency (ESA: Keizai Antei Honbu), representatives from financial and other industries. The BOJ was to obey the policy designed by the Committee and to function solely as a note-issue bank. Interesting to note is that this idea was similar to the "Banking Board" subsequently proposed by the SCAP.

The issue at stake concerning the central banking reform was whether the money supply should be determined within, or outside the

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[45] Buchheim (1993), pp. 69-83.

[46] Letter from the Allied Bank Commission ABC/DIR(48)12, June 1948, BEA, OV 34/228, with which this authority was transferred to the Bank deutscher Länder. See also Buchheim (1990), pp. 62-3.

[47] The currency reform and its consequences, as well as the reasons for the continuing dollar gap, were described with impressive clarity by Abs (1950), pp. 481-8.

[48] MOF (1976), pp. 47-53. For more details of the central banking reforms, see BOJ (1985), MOF (1983) and Muto (1984, 1985, 1991).

MOF. In fact, the Currency-Issue Council was established in December 1947. The Japanese government initially intended to define its task as merely giving advice to the Finance Minister on the maximum limit of the currency issue. But later, in accordance with a requirement of the SCAP, its task was changed from advising to deciding on the money supply. This Council did not actually function well, however, because the extent of the money supply could not be determined independently of the fiscal needs, in particular during the years of the postwar inflation.[49] The WPI of all commodities stood 4.6 times in 1946, 13.8 times in 1947, 36.5 times in 1948 and 59.7 times in 1949 as high as in 1945.[50]

After the reform plans from the Japanese side had been announced, but had eventually failed except for the Currency-Issue Council, the ESS submitted to the Japanese government, in August 1948, "an informal memorandum" on the overall revision of the banking structure. The term "informal" was applied, because it was not yet authorized by the War Department in Washington. The Banking Board proposed in this memorandum would stand outside the BOJ, with Cabinet rank and independent of the MOF. It would be in charge of the monetary and credit policy and the supervision of all financial institutions. The BOJ would be reorganized as a Reserve Bank of Japan and charged only with implementing the policy determined by the Board. All private banks would be obliged to participate in the Reserve Bank System. Naturally, this plan was based on a federalist idea with the FRB in mind. But the Board would be empowered with far more responsibilities than the Finance Agency proposed by the Japanese side and even than the FRB in the United States.[51]

The Japanese counterpart for the reform negotiation was the troika of the MOF, the BOJ and the ESA. The Japanese side resisted to the US proposals on the ground that a "Board" independent of the MOF was not only unpractical, because public finance and banking were closely interrelated, but also needless since the BOJ had been in charge of monitoring and controlling financial institutions.[52] Because Japan was a small country compared to the United States and was not divided up by Occupation Powers like Germany, this idea turned out to be unrealistic in the end.

The War Department in Washington was opposed to the idea of the Banking Board in October 1948. The reason was that the control of inflation was regarded as the primary objective, and that a radical reform of the financial system, including the establishment of a Board, would hamper an effective anti-inflation policy. Part of the US government in Washington clearly preferred stabilization to radical reforms. Cagle responded in November that the Banking Board was a prerequisite for the stabilization, since a powerful and permanent monetary agency independent of politics would constitute an indispensable element to the above objective. The main difference in opinion was whether to give more power to the BOJ or to set up a new

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[49] Kato (1974), pp. 335-6. BOJ (1985), pp. 136ff.

[50] Ohkawa et al. (1967).

[51] Tsutsui (1988) p. 78 and Muto (1991).

[52] BOJ (1985), p. 288.

organ outside the central bank. The SCAP had been worried about the one-man control, which had resulted in a permissive stance toward the inflation, by Hisato Ichimada (the Governor of the BOJ from June 1946 to December 1954), who was often compared to the Pope in the Vatican.

At the end of 1948, the Chief of the ESS-Finance Division finally achieved a compromise, "a Policy Control Board within the framework of the BOJ".[53] The transformation of the "Board" from an outside organization to an insider of the BOJ was promoted by Ichimada against strong opposition, according to his own statement. But a very important background was that the 9 principles and the appointment of Dodge had been announced in between. In March and April 1949, Dodge met Ichimada in order to exchange opinions over the financial reform. Ichimada finally agreed with the Policy Board proposal within the BOJ.[54]

The Policy Board, established in June 1949, is one of the rare examples for success of the financial reform ideas of the SCAP. The members of the Board consisted of the Governor of the BOJ, representatives from the MOF and the ESA, local and city banks, agriculture, industry and commerce, respectively. Nevertheless, in fact it remained "a sleeping board", because the principles of the BOJ Law remained intact. The Board has been chaired by the Governor of the BOJ ever since.

The history of the central banking reform in Japan reveals the continuity of such strong ties between the BOJ and the government that even the SCAP could not substantially modify them. It is remarkable that the BOJ Law of 1942 constitutes even today the legal framework of the Japanese central bank. Accordingly, its independence of the government is largely restricted.

Currency reform and of monetary policy performance:

Inflation shortly after the war was quite high in Japan. At the end of the war, the total financial assets amounted to no less than 500 billion yen, while the GNP in 1944 is estimated at only 74.5 billion yen. This wide gap between the potential purchasing power and the national product led to the high inflationary pressure. The stock of BOJ notes circulating in public increased from 30.3 billion yen (mid-April) to 55.4 billion yen (year-end of 1945). Consumer prices on the black market, in particular, skyrocketed; they were 37 times as high as the official prices at the end of 1945.[55]

Compensation payments for war-time financing mainly caused the government deficits, which was monetized by the BOJ. Deposit accounts at banks were kept open for withdrawals. As early as November 1945, the Finance Minister announced a scheme for introducing the "new yen" and for a new tax on property and war-time profits. This announcement brought about accelerated deposit

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[53] Almost simultaneously, the MOF, associated with the BOJ, submitted a proposal of the Finance Industry Law in December 1948. The Chapter 3 dealt with reforming the BOJ.

[54] Muto (1985 a,b), BOJ (1985), pp. 295-301.

[55] BOJ (1985), pp. 4, 15-6.

withdrawals and subsequent purchases of real goods. The government had no other option than taking immediate actions: emergency measures against the economic crisis, which included naturally a currency reform.

The emergency financial measures and the ordinance to deposit BOJ notes in February 1946 determined that the "old yen" would cease to be legal tenders. Those who held "old yen" were obliged to deposit them in closed accounts at financial institutions. Depositors were allowed to withdraw only 300 yen per household head and 100 yen per additional family member, in "new yen" notes. Moreover, firms were allowed to pay business expenses in "new yen", and the governmental payments also provided cash to the public. Accordingly, the money supply by the BOJ statistically did not contract on a permanent basis, although the urgent task for the monetary authority was the control of the postwar inflation. The BOJ note issue declined from a peak of 62 billion yen (mid February) to 15 billion yen (mid March), thereafter it increased to 23 billion (end of March), 64 billion (end of September) and 93 billion (end of December, 1946).[56]

The reconstruction of the economy and the price stabilization were not separated issues, as far as the excess demand could be satisfied through expanded supply.[57] The well known reconstruction policy, named Priority Production System, was based on the priority allocation of funds, to which the BOJ contributed through controlling the fund allocation, directly and indirectly.[58] In this sense, the role of the BOJ did not decline after the war.

1) The BOJ contributed directly, in the sense that it implemented the Rules of Funds Supply (Kinyu-kikan Shikin Yuzu-junsoku) since March 1947, which induced financial institutions to provide credit to key industries, such as coal-mining, iron and steel, fertilizers, electric power, and also to invest in government bonds. The Temporal Fund Adjustment during the War was the forerunner of this system.
2) The BOJ contributed indirectly, through making bills issued by the above industries eligible for collateral at the BOJ and thus lowering borrowing cost. The Reconstruction Finance Bank (RFB: Fukko Kinyu Kinko) was established in January 1947. After negotiations with the Japanese government, SCAP approved the idea of this institution, probably because of its resemblance to the U.S. Reconstruction Finance Company.[59] The RFB was mainly financed by the BOJ. It purchased 71% of the finance bonds issued by the RFB during the period 1947-48. The RFB, on its part, supplied funds largely to the key industries for the sake of economic reconstruction.
3) Moreover, the BOJ organized loan syndicates. From January 1947 to April 1950, the BOJ took the leadership for the 5964 syndicates which amounted to 315 billion yen in total.

[56] BOJ (1985), pp. 44-5, 77-8.
[57] For problems during the inflation, see Hamada and Kasuya (1993).
[58] Teranishi (1993), pp. 169-70.
[59] As stated in MOF (1976), pp. 624-25.

The BOJ thus assisted key industries in the postwar years. The question is whether this enlarged role was promoted by, or realized despite, the SCAP policy. Since the measures 1), 2) and 3) had been experimented with during the war, and purchasing the RFB bonds was, in its essence, similar to monetizing government bonds, we can conclude that the continuity of the system worked in favour of the reconstruction of the Japanese economy. The reason SCAP permitted such a continuity can be attributed to the same circumstances as those that determined the whole financial reform package.

Dodge, heading the financial department of the US military government in Occupied Germany, had prepared a report for the currency reform in the three Western zones of Germany. Due to this carrier, he was appointed as an adviser for reconstructing the Japanese economy.[60] However, as stated above, the currency reform in Japan had been undertaken almost three years before his appointment in 1949.

Inflation did not disappear even after the currency reform, however. The WPI in the free market of [which month?] 1948 stood 4.8 times as high as in August 1946. Dodge pursued a stabilization policy in accordance with the liberalists' tendency within the 9 principles and neglected intentions of both the Japanese government and the SCAP which desired a mild course of the stabilization. The policy named the Dodge Line was characterized by a balanced budget, coupled with suspension of the RFB credit, and the single exchange rate parity of 360 yen/dollar. The single exchange rate was a very important step toward the stabilization of prices, because Japanese exports had been undervalued and imports overvalued; differentials between the official prices in yen and the international prices had been subsidized by the Special Trade Financial Account (Boeki-kinyu Tokubetsu Kaikei). The BOJ had financed the deficits of this Account.

From March 1949 onward, the Japanese economy encountered a severe deflationary pressure under the Dodge Line. The WPI in the free market actually declined 16% between 1949 and 1950. The government tried to relax the credit supply through a so-called disinflation policy, providing an increased scale of public funds, post-savings for example. The BOJ credit constituted a part of this policy. The provision of public funds paved the way for the Fiscal Loan and Investment Program (FILP) in later years. The outbreak of the Korean War in June 1950, finally, ended the deflationary tendency. As the Korean-War boom disappeared, the Currency-Issue Council was abolished, simultaneously with the ESA, in July 1952, and thereafter, the MOF regained the power to decide on the maximum limit of the note issue.

5. Results of the German-Japanese comparison

Central banking in Japan displayed a number of similarities to its German counterpart up to 1945. More precisely, Japanese policy

[60] Hamada and Kasuya (1993), p. 174.

makers learned and followed the German experience almost at every turning point of pre-1945 monetary history. However, the postwar history showed differences rather than similarities.

In retrospect, the US policy during the Occupation left little impact on the central banking as well as on the whole financial system in Japan. One reason is that the reform plan was unrealistic. The federalist idea of organizing the central bank was based on the historical characteristic of the US economy, whereas the BOJ was established as early as 1882 and had constituted an integral part of the economic policy. The policy aimed at dissolving the historical background had to encounter strong resistance.[61]

While the same reason could be applied to Germany, the outcome of the central banking reform was quite different. The difference resulted from the fact that the Occupation policy was indirect and milder in the sense that Japan maintained a unified central government under the Occupation.

However unrealistic the reform plan would have been, if the SCAP and Washington had maintained a firm and consistent stance, the outcome of the financial reforms in Japan might have been different from the situation we have reviewed above. The Cold War and the subsequent "reverse course" of the occupation policy were in this respect important factors, and the divided opinions within the US camp allowed the Japanese opposition to disturb the actual implementation of the reform.

In West Germany, in contrast, American occupation policy left a big imprint on the central banking system up to today. Its federal structure, according to the home model of the U.S., still constitutes the basis of the Bundesbank, although not quite to the same degree as during the existence of its forerunner, the Bank deutscher Länder, from 1948 to 1957. It's centralized elements were created over the original opposition of OMGUS largely thanks to the insistence of the British occupation authorities, whose concern for economic efficiency of the financial sector prevailed over the original American intent to give a higher priority to the political goal of democratization and federalization, also of the financial structure, than to economic efficiency. In contrast to Japan, German politicians had little influence on the central banking reform. As no central German government existed before the Federal Republic was founded in September 1949, German politicians mainly voiced the interest of the *Länder* that they represented and thus were in principle not unfavorable to the American federalist tendencies.

The differences of opinion within the U.S. Administration and occupation authorities early on had helped Japanese central government politicians to preserve the traditional centralized banking structure of the BOJ and the big banks, although there was no British Ally involved. But Cold War developments as well as the election of a business-minded Republican majority in the Congress in November

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[61] Kato (1974), pp. 347-48. Tsutsui (1988, p. 118) states that "In general, the Americans' grand reform proposals were inherently weak and superficial, founded on questionable assumptions and characterized by an essentially ethnocentric orientation".

1948 not only softened the American will to impose foreign solutions to occupied Japan, but also contributed to the basic shift of American occupation policy in Germany from far-reaching ideological reform goals to pragmatic and cooperative solutions. The difference to Japan in banking policies was only that the American decisions to abolish the old centralized Reichsbank and to decentralize the German central banking structure (and the big banks) had already been taken and executed in Germany by the time the Cold War and a Republican majority in Congress had softened the American stance. For Japan these developments came still in time to preserve the big banks when a decision on their future structure became due in the fall of 1948, and to preserve the traditional role of the BOJ when Joseph Dodge arrived in 1949 to shape his financial reform program.

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