Session: Keynesianism: Its Rise, Fall, and Transformation in Europe and North America

Keynesianism in Germany

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Abstract

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Keynes had been a central point of reference in debates on economic theory and policy in Germany ever since his *The Economic Consequences of the Peace* (1919), as, e.g., in the controversial debates on the wage-employment relationship at the end of the Weimar Republic. No wonder that the first foreign language-translation of the *General Theory* was published in German. With the great resonance Keynes had in Germany in the interwar period it is no surprise that from the early 1950s onwards neoclassical synthesis Keynesianism became the dominant approach at West German universities. More astonishing is the fact that with Erich Schneider at Kiel a former student of Schumpeter played a key role in this process. In economic policy, however, Keynesianism gained a rather late entry in the recession of 1967 and lasted only until 1974-5.

**Keywords:** Bundesbank, Carl Föhl, Wilhelm Lautenbach, Karl Schiller, Erich Schneider, Stability and Growth Act

**JEL codes:** B0, E6, H0
Keynes had been a central point of reference in debates on economic theory and policy in Weimar Germany ever since his resignation as a senior Treasury representative at the Versailles Treaty negotiations and making his opposition against the terms proposed on Germany public in his pamphlet *The Economic Consequences of the Peace* (1919). This book, which was also translated into ten other languages and made Keynes world-famous for the first time, was published in a German translation *Die wirtschaftlichen Folgen des Friedensvertrages* (1920) by Moritz Julius Bonn in co-operation with Carl Brinkmann within six months. The book was a great success in Germany: ironically, on the nationalist right similar misunderstandings prevailed as in the Allied countries where Keynes was accused of being pro-German whereas in fact he was pro-European, worrying not only about Germany’s limited capacity to pay unrealistically high reparation payments but also about the absorption problem in the recipient countries and above all the reconstruction of the shaky post-war European economies.

During the armistice negotiations early in 1919 Keynes befriended Carl Melchior, partner in the merchant bank Warburg in Hamburg and chairman of the German finance delegation, with whom he cooperated in the reparation diplomacy and whom he attested to uphold “dignity in defeat” (Keynes 1972, p. 403). During the Weimar years Keynes’s essays were regularly published in the influential economic magazine *Der Wirtschaftsdienst* in Hamburg which made Keynes’s views immediately known to the German public. No less than 51 essays were published in the years 1920-1932 (Keynes 2016). The magazine was edited from 1920-27 by Kurt Singer, “two foot by five, the mystical economist from Hamburg” (Keynes 1972, p.383) and subsequently by Eduard Rosenbaum until the latter’s dismissal by the Nazis in April 1933. Rosenbaum had assisted Melchior as an expert in the Paris negotiations in spring 1919 where he came to know Keynes, who later supported Rosenbaum after his emigration to England in 1934 to become a temporary assistant of Sraffa.
before he gained recognition as a librarian of the London School of Economics from 1935-52. Rosenbaum was among the “enemy aliens” for whose liberation from internment prison on the Isle of Man Keynes was fighting in summer 1940 (Hagemann 2007: 325).

Keynes was also a central point of reference in the debates on the wage-employment relationship in Weimar Germany, particularly after the outbreak of the Great Depression in 1929 when controversies intensified. After Britain’s return to the gold standard in April 1925 at the pre-war parity of $ 4.86 for the pound sterling, which caused the level of money wages to be 10 per cent too high as a consequence of the overvaluation of the pound according to the calculation of Keynes who had heavily but unsuccessfully opposed the decision in his pamphlet “The economic consequences of Mr. Churchill”, the British export industry ran into troubles. The resulting controversies on the wage-employment nexus had many parallels with the German controversies where the reparation payments imposed by the Versailles Treaty implied the necessity to generate export surpluses. This caused industry and orthodox economists to call for a deflationary wage policy to increase international price competitiveness even louder in the Great Depression, when it succeeded with disastrous economic and political consequences. However, there was a minority group of “economic activists” in pre-Hitler Germany who emphasized that wage reductions aggravate the deflationary process in the depression and cause higher unemployment, such as Keynes argued against the “classical doctrine” that a decrease in money wages is a general remedy for fighting mass unemployment. Although they fully agreed with Keynes in the policy conclusions including the advocacy of public works, there were some differences in the theoretical foundation (Garvy 1975, Bombach et al. 1976, 1981, Hagemann 1999).

The first foreign-language publication of *The General Theory of Employment, Interest and Money* by John Maynard Keynes was published in German in the same year as the
English original in 1936\(^2\). It was in Germany that “A Monetary Theory of Production” (Keynes 1933), the outline of his research programme in which he confronted his desired monetary economics in which money is not neutral with the real-exchange economics dominant in traditional economics, had been published as his contribution to the *Festschrift* for Arthur Spiethoff in 1933, when Keynes was half-way from his *Treatise on Money* (1930) to the *General Theory*. However, with the Nazis’ rise to power, this year also marked a significant political watershed. The dismissal, expulsion and emigration of economists had the consequence that many of the most qualified earlier reviewers of and commentators on the *Treatise*, such as Hans Neisser or Wilhelm Röpke, were not living in Germany anymore when the *General Theory* was published. However, the extent and intensity of the early reactions to Keynes’s book in the German language area as well as by German-speaking émigré economists were remarkable (Hagemann 2008).

Nevertheless substantial and insightful review articles were published by German economists of whom Carl Föhl and Hans Peter, who both made an academic career only after World War II, are worth mentioning as well as Wilhelm Lautenbach, a high-ranked theorizing practitioner in the Ministry of Economics who sometimes was called the “German Keynes” (Backhaus 1985). Lautenbach defended Keynes’s liquidity preference theory against critics but pointed out:

> The understanding of this theory and its importance would have been made easier if Keynes would have done more justice to his predecessor Wicksell and his pupils. The *General Theory* is the end of a line which leads from Wicksell’s *Interest and Prices* via the *Treatise on Money*. Keynes has gone the path on which Wicksell and his pupils had been the first pioneers, to the end. He does not destroy the classical theory, but basically he is the saviour. He cleans classical theory from scholastic aberrations and collusion (Lautenbach 1937:523).
Föhl also published an important book of his own Geldschöpfung und Wirtschaftskreislauf (Money creation and the economic circular flow) (Föhl 1937) which reviewer Hans Singer in the Economic Journal classified as “a first cousin to the General Theory, being a development of the “Treatise” analysis cum “Means to Prosperity” cum the “Psychological Law” from the General Theory”, but also points out the influences of German monetary economics and rightly assesses Föhl’s book as an “outstanding achievement” (Singer 1938 pp.79-80).

Substantial review articles were also published in the German language area by important Austrian and Swiss economists such as Alfred Ammon or Walter Jöhr, or by émigré economists who still could publish in Austrian journals such as Gottfried Haberler’s early critique of Keynes’s multiplier analysis (Haberler 1936). Of some interest is also the article “Keynes’ Revision of Liberal Economics” which Kurt Mandelbaum (Martin), who later earned a name as a development theorist, published under the pen name Erich Baumann (1936) in the journal of the Frankfurt Institute of Social Sciences, at that time located in Paris. There Mandelbaum criticizes Keynes from an enlightened perspective of a Marxian accumulation theory, complaining that Keynes neglected the role of technical progress, profit expectations and structural disproportionalities, the new liquidity preference theory and Keynes’s occasional relapsing into a primitive underconsumption theory. Positively Mandelbaum comments on Keynes’s consideration of psychological factors and his rejection of Say’s law (although Marx had done the job much earlier).

With the great resonance Keynes had in Germany in the interwar period it is no great surprise that it took only a rather short time that from the early 1950s onwards for Keynesianism of the Hicks-Modigliani-Samuelson type to evolve into the dominant approach within the West German economics profession, with the exception of a few faculties such as
Freiburg or Cologne where the ideas of Ordoliberalism respectively of the economic style of
the social market economy were prevailing. More astonishing is the fact that a key role in
this process was played by a former student and protégé of Schumpeter: Erich Schneider
(1900-1970), first a high school teacher in mathematics, who obtained his habilitation from
the University of Bonn in 1932 with Schumpeter as his main supervisor. Schneider, who had
obtained a full professorship in Aarhus in 1936, came back from Denmark to Germany in
January 1946 where he held the key chair in economics at the University of Kiel until his
retirement, from 1961-69 also acted as the Director of the prestigious Institute of World
Economics. Schneider exerted his influence mainly via two channels. After the Verein für
Socialpolitik, the association of economists in the German language area, had been refounded
in 1948 (In December 1936 the majority of the members had decided to dissolve the Verein in
order to escape the Gleichschaltung by the Nazis), Schneider took the initiative for the
reconstitution of the key Committee for Theory in 1949 which began with its regular
scientific meetings in 1953 (Schefold 2004). Against some resistance among the older
members, Schneider, who remained the committee’s chairman until 1962, used his role to
guide his peers, particularly the majority of the most promising economists of the younger
generation, to a more mathematically oriented approach. Schneider was an ardent believer of
neoclassical synthesis Keynesianism to which he added some Scandinavian flavour. Having
lived in Denmark for a decade, he was impressed by the work of the Stockholm School and in
particular, as his teacher Schumpeter, a great admirer of the work of Ragnar Frisch.

Schneider was also the author of a most successful textbook which became the canon
in economics for two decades. His Einführung in die Wirtschaftstheorie (Introduction into
Economic Theory: vol.1, National Income Accounting, vol.2, Microeconomics, vol.3,
Monetary Macroeconomics) were first published between 1947 and 1952 and went into
double-digit editions in the subsequent two decades. The sales figures of the three volumes
where 83,200 respectively 80,200 and 68,500 (Häuser 2010:260 n.67). English versions of volumes 2 and 3, which were also translated into several other languages, were published as *Prices and Equilibrium: An Introduction to Static and Dynamic Analysis* and *Money, Income, and Employment* respectively in 1962 by George Allen & Unwin in London. The reviewer Kurt Rothschild classified these books in *The American Economic Review* as “one of the best introductions to modern economic analysis available” (1964:4).

The dissemination of Keynesian ideas and doctrines was reinforced by Andreas Paulsen (1899-1977) who held the chair of economic theory at the Free University of Berlin from 1949 until his retirement in 1967. Paulsen considered the General Theory as the most important work in economics in the twentieth century. In his *Neue Wirtschaftslehre (New Economics)* Paulsen (1950) gave a condensed summary of Keynes’s theory in the spirit of Alvin Hansen. He also contributed significantly to the dissemination of Keynesianism by his textbook (Paulsen 1956), which was available in a cheap paperback edition and widely used by students in combination with the theoretically more demanding Schneider books. The dominance of neoclassical synthesis Keynesianism was enhanced by the fact that the publishing house of the German trade unions published a German translation of Paul Samuelson’s successful textbook as early as January 1952. When in 1969 it went into the fourth edition already 64,000 copies were printed.

Whereas a moderate Keynesianism of the Hicks-Samuelson neoclassical synthesis had dominated economic theory at most West-German universities since the late 1950s, in international comparison Keynesianism gained a rather late entry into economic policy. It took until the recession of 1966-67 and the first post-war admittance of the Social Democratic Party (SPD) into government, in the “Grand Coalition” with the Christian Democrats (CDU/CSU) formed in December 1966, with the charismatic Social Democrat Karl Schiller as
the new economics minister until the summer of 1972. The German economy recovered quickly from the 1966-67 recession in the following year, due to two public investment programmes launched in January and July 1967, moderate wage settlements and a strong growth in exports fostered by an undervalued Mark. A milestone was the ratification of the Stability and Growth Act by the Bundestag in June 1967, which is still valid today. According to Article 1 the federal and state governments “have to respect the requirement of macroeconomic equilibrium in their economic and financial policy measures which have to be taken in a way that they contribute, within the scope of a market economy, to simultaneously achieve stability of the price level, a high level of employment, and external equilibrium, together with steady and appropriate growth”. These four macroeconomic goals, the so-called “magic quadrangle”, appeared already in the statutes of the German Council of Economic Advisers, founded in 1963 and presenting its first annual report in autumn 1964. In contrast to the American CEA the German one is an external and independent committee of five members rather than part of the government. Whereas fiscal policy is responsible for four macroeconomic goals, monetary policy, as written in the Constitution of the Bundesbank (and later taken over in the Constitution of the European Central Bank), is responsible only for price stability. This has led repeatedly to tensions, particularly in the recessions after the first and second oil-price shock in the mid-1970s and 1979-82 respectively. It also marks a difference from the United States where the Federal Reserve is responsible for the growth and employment goals too.

Even in the heyday of Keynesian economic policy from 1966-7 to 1974 Keynesian policies took on a distinctly German tinge. Schiller had always followed a synthesis of Keynesianism with ordoliberal ideas, as best expressed in his influential article on economic policy, in which he formulated his famous leitmotiv “competition to the extent possible, planning to the extent necessary”, i.e. a synthesis of macroeconomic demand management
with the Freiburg imperative of a market economy (Schiller 1962). That Keynesianism even in its most popular years was a moderate economic policy is also the consequence of two decisive restrictions. The SPD as the main carrier of Keynesian economic policies never had an absolute majority, but first was a junior partner in the coalition with the CDU/CSU, and thereafter from 1969 onward needed the Free Democratic Party (FDP), which terminated the social-liberal coalition in 1982 over controversies on economic policy in the recession after the second oil price shock. Furthermore, the Bundesbank had always been a powerful institution that followed its own policy of securing price stability, thereby constraining the implementation of Keynesian full employment policies. When the German economy, unusually, ran into a current account deficit in 1979-81 after the second oil price shock, the Bundesbank reacted with a very restrictive monetary policy of raising interest rates. This led to a major controversy with the Social Democratic Chancellor Helmut Schmidt, who complained about the negative consequences on investment and growth, and contributed to his overthrow. In the election campaign to the Bundestag in 1972, when he was “super” minister for finance and economics, Schmidt had made the famous statement, “better 5 percent inflation than 5 percent unemployment”, thus indicating that the idea of a Phillips curve trade-off had gained ground in the political sphere, particularly among social democrats and trade unionists. However, with mounting inflationary pressures in the 1970s and a strong increase in unemployment in the 1974-75 recession, Keynesian ideas lost ground in economic theory and policy.

After December 1974, when for the first time it had announced a target for the growth of the money supply, the Bundesbank followed an explicit monetarist policy. The CEA stated in its 1974-75 report that it is not the task of monetary policy to solve unemployment problems and from 1976-77 on explicitly propagated a supply-side oriented policy, ignoring the demand side almost completely. The strong anti-Keynesian position of its majority and the
critique of the too high wage level, which was made responsible for the increasing unemployment, caused a permanent conflict with the trade unions.

The main vehicle of the breakthrough of monetarist ideas had been the Constance seminar on monetary theory and policy, which had been initiated by Karl Brunner and since 1970 brought together economists from North America and Europe with practitioners from central and commercial banks. With the worsening stagflation after the first oil-price shock monetarism gained ground. After the late and triumphant rise of a moderate Keynesianism in German economic policy, the mid-1970s marked the fall of Keynesianism and the rise of supply-side policies. This turn in economic policy was enhanced by the consequences of the second oil-price shock which led to a slackening of growth, high and persistent unemployment at a level not known since the 1950s, and finally a change in government in 1982, with the Christian Democrat Helmut Kohl remaining Chancellor for sixteen years. However, neoliberal economic policy-making by the Kohl government in the 1980s was relatively moderate compared with Reagan’s policy in the United States or Thatcher’s policy in the United Kingdom. In the 1990s macroeconomic policies had to cope with the consequences of German unification. The new coalition between the Social Democrats and the Green Party, with Gerhard Schröder as the Chancellor from 1998-2005, first benefitted from the New Economy boom before, at the end, they were forced to engage in labour market reforms, the so-called Agenda 2010, when Germany had more than five million unemployed persons. These reforms, which were more in the spirit of “New Labour” than inspired by Keynesian ideas, are still controversially discussed. They contributed to halve unemployment but at the expense of many more precarious jobs and a decline of electoral support for the SPD by trade unions and workers. A temporary rise and comeback of Keynesianism can be observed in the reaction of the second grand coalition between CDU/CSU and SPD to the global financial and economic crisis of 2007-9. The expansionary policies contributed
substantially, together with an export boom to China and other catching-up economies, that the deep recession between October 2008 and summer 2009 (causing a growth rate of GDP of minus 5 percent in 2009) was overcome quickly thereafter.

In economic theory equilibrium and real business cycle theories never dominated at the universities as much as in the United States. At most places the “new neoclassical synthesis” or “New Keynesianism” have been the influential approach in macroeconomics.

In 2003 the Keynes Gesellschaft\(^5\) was founded at the initiative of Jürgen Kromphardt, a former PhD student of Erich Schneider in Kiel, member of the CEA from 1999-2004 and professor emeritus at the Technical University of Berlin. After the Great Recession many younger economists engaged in the annual meetings of the Keynes Society which, by 2018 has 170 members. Kromphardt also initiated that the defective German translation of the General Theory was completely revised with the 10\(^{th}\) edition in 2006, with the support of Stephanie Schneider, and further improved with the 11\(^{th}\) edition in 2009, with explanations on the structure of Keynes’s book and references to the page numbers of the English original on every page. The publication of a completely new translation by Nicola Liebert after the end of the copyright in 2017 by Keynes’s old German publisher Duncker & Humblot in Berlin indicates a lasting interest respectively the “return of the Master” (Skidelsky) after the Great Recession.

In the last two decades Berlin has also developed to become the main international meeting place for (Post-)Keynesians. In autumn 2018 the Forum for Macroeconomics and Macroeconomic Policies FMM organizes the 22\(^{nd}\) conference with meanwhile more than 300 participants from all over the world. The FMM is supported by the Institute of Macroeconomics and Business Cycles Research IMK of the Böckler Foundation, i.e. the research foundation of the German trade unions. It considers macroeconomic theory “as the
basis for policies which aim at high employment, environmentally sustainable growth, price
stability, reduced inequality, and the elimination of poverty” (FMM Website). It also offers a
biannual international summer school to graduate students which “aims at providing an
introduction to Keynesian macroeconomics and to the problems of European economic
policies”. It is also strongly linked with the *European Journal of Economics and Economic
Policies: Intervention*, first published in Germany in 2004 and since 2013 published by
Edward Elgar.

NOTES

1 Keynes’s collected essays were re-published at the occasion of the centennial of *Der
Wirtschaftsdienst* in 2016.
2 For controversies which evolved around interpretations of the Preface Keynes wrote for the German
dition see Schefold (1980) and Hagemann (2014).
3 See also Hutchison (1979) and Peacock and Willgerodt (1989).
4 On Schneider’s life and work see Häuser (2010)
5 See http://www.keynes-gesellschaft.de
6 See http://www.fmm-macro.net
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