

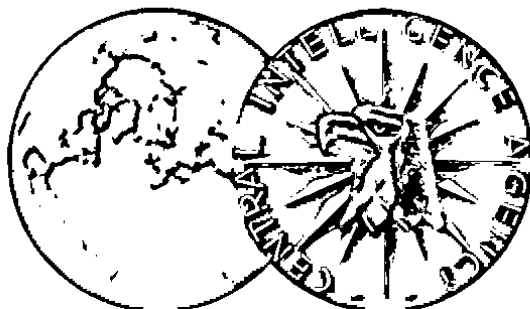
COPY NO.

~~SECRET~~

FOR THE ASSISTANT DIRECTOR
FOR REPORTS AND ESTIMATES

GERMANY

FORM 87



SR-20

Published 9 December 1949

78-1617A 15

CENTRAL INTELLIGENCE AGENCY

Document No: 001

NO CHANGE in Class.

DECLASSIFIED

Class. CHANGED TO: TS S C

DDA Memo, 4 Apr 77

Auth: DDA REG. 77/1783

4 CFR 107a

~~SECRET~~

15-235017/1

F12

WARNING

This document contains information affecting the national defense of the United States within the meaning of the Espionage Act, 50 U.S.C., 31 and 32, as amended. Its transmission or the revelation of its contents in any manner to an unauthorized person is prohibited by law.

TOP SECRET

SECRET

DISSEMINATION NOTICE

1. This copy of this publication is for the information and use of the recipient designated on the front cover and of individuals under the jurisdiction of the recipient's office who require the information for the performance of their official duties. Further dissemination elsewhere in the department to other offices which require the information for the performance of official duties may be authorized by the following:

- a. Special Assistant to the Secretary of State for Research and Intelligence, for the Department of State
- b. Director of Intelligence, GS, USA, for the Department of the Army
- c. Chief, Naval Intelligence, for the Department of the Navy
- d. Director of Intelligence, USAF, for the Department of the Air Force
- e. Director of Security and Intelligence, AEC, for the Atomic Energy Commission
- f. Deputy Director for Intelligence, Joint Staff, for the Joint Staff
- g. Assistant Director for Collection and Dissemination, CIA, for any other Department or Agency

2. This copy may be either retained or destroyed by burning in accordance with applicable security regulations, or returned to the Central Intelligence Agency by arrangement with the Office of Collection and Dissemination, CIA.

DISTRIBUTION:

Office of the President
National Security Council
National Security Resources Board
Department of State
Office of Secretary of Defense
Department of the Army
Department of the Navy
Department of the Air Force
Joint Chiefs of Staff
Atomic Energy Commission
Research and Development Board

SECRET

SECRET

SR-20

GERMANY

TABLE OF CONTENTS

SUMMARY

CHAPTER I—POLITICAL SITUATION

	Page
1. GENESIS OF THE PRESENT POLITICAL SYSTEM	I - 1
2. PRESENT GOVERNMENTAL STRUCTURE	I - 4
3. POLITICAL PARTIES AND CURRENT ISSUES	I - 5
a. Soviet Zone	I - 5
b. UK Zone	I - 7
c. French Zone	I - 9
d. US Zone	I - 10
4. OTHER INFLUENTIAL GROUPS	I - 14
5. THE BERLIN SITUATION	I - 16

CHAPTER II—ECONOMIC SITUATION

1. GENESIS OF THE PRESENT ECONOMIC SYSTEM	II - 1
2. DESCRIPTION OF THE PRESENT ECONOMIC SYSTEM	II - 2
a. Agriculture	II - 2
b. Natural Resources	II - 6
c. Industry	II - 12
d. Financial	II - 21
e. International Trade	II - 30
3. ECONOMIC STABILITY	II - 34
a. Western Zones	II - 34
b. Soviet Zone	II - 35

CHAPTER III—MILITARY SITUATION

1. ORIGIN OF THE PRESENT MILITARY SITUATION	III - 1
2. STRENGTH AND DISPOSITION OF ARMED FORCES	III - 2

CHAPTER IV—STRATEGIC CONSIDERATIONS AFFECTING US SECURITY

1. GENERAL	IV - 1
2. POLITICAL FACTORS	IV - 2
3. ECONOMIC FACTORS	IV - 3
4. MILITARY FACTORS	IV - 4

CHAPTER V—PROBABLE FUTURE DEVELOPMENTS AFFECTING US SECURITY	V - 1
--	-------

APPENDIX A—Terrain and Climate

APPENDIX B—Significant Communications Facilities

SECRET

SECRET

APPENDIX C—Population Statistics and Characteristics

APPENDIX D—Significant Biographical Data

APPENDIX E—Chronology

MAPS:

- Germany—Principal Roads and Railroads**
- Germany—Principal Industries**
- Germany—Production of Fuels**
- Germany—Production of Metallic Ores**
- Germany—Production of Non-Metallic Ores**
- Berlin**
- Germany—Occupation Zones, Air Corridors**

SECRET

SUMMARY

After the establishment of the German Empire in 1871 by Bismarck, Prussian influence and Prussian bureaucratic methods permeated the rest of Germany, centralization of the government was heightened, and federalistic elements were correspondingly weakened. This development was interrupted only slightly by defeat in the first World War and the establishment of the more liberal but ephemeral Weimar Republic. Under Nazi control the unitary or totalitarian principle of the state reached its apotheosis. Total defeat in the second World War left the Germans powerless to decide their own immediate fate, but it has not materially weakened their attachment to the strongly centralist and nationalist principles to which they have been accustomed under a variety of regimes.

The objective of Allied occupation policy in the Potsdam Agreement was to encourage the political reconstruction of Germany along decentralized federalistic lines, but the division of the country into four zones created a pattern of conflicting ideologies which ultimately crystallized into the present split between the Soviet Zone and the three united western zones. Potsdam political principles were not applied uniformly by the four powers, and the development of German political parties was largely a reflection of the ambitions of the individual occupying powers. In the Soviet Zone the Communist Party (SED), although numerically the weakest, enjoyed a dominant position by virtue of Soviet military support. In the French Zone the occupying power favored the German particularist parties which have always opposed a close union with the German Reich. Only in the US and UK Zones were political parties permitted a more nearly normal development, although here again subordination to the authority of the occupy-

ing power resulted in an avoidance of responsibility on the part of German political leaders and a general apathy on the part of the electorate. In the three western zones the Communist Party (KPD), in addition to being under close surveillance by the authorities, has failed to attract any substantial support and is therefore a negligible factor except for its rather limited subversive potentialities. Conversely in the Soviet Zone, opposition parties have existed only upon the sufferance of the Soviet military authorities, and their ranks have been repeatedly purged of elements considered dangerous to Communist control. Consequently, to the regret of all Germans, the country has been split into Communist and non-Communist controlled areas.

Quadripartite control of Germany through the Allied Control Council in Berlin was never successfully implemented because of the obstructive attitude of the USSR and, to a lesser extent, of France. In March 1948 the Council ceased to function on a quadripartite basis when the Soviet representative withdrew on the ground that the steps taken by the US and the UK to reorganize and strengthen the political machinery of the Bizonia constituted an infraction of the Potsdam Agreement. The USSR thereupon reorganized and activated the German Economic Commission (DWK) for the Soviet Zone by conferring upon it extensive powers over the zonal economy and by staffing it with reliable German Communist leaders. The police powers of the German Administration of the Interior (GAI) were placed upon a more effective basis, and the exploitation of such popular front agencies as the People's Congress (*Volkskongress*) and the People's Council (*Volksrat*) for propaganda purposes was greatly increased. The

Note: The intelligence organizations of the Departments of the Navy and the Air Force have concurred in this report. The Department of the Army has concurred in this report with the exception of Chapter II on which it had no comment. For dissents by the Department of State, see Enclosures A and B following Page V-3. The report contains information available to CIA as of 1 September 1949.

SECRET

i

Soviet Zone was thereby provided with the framework for an eastern German state.

In western Germany, as a result of the London Agreements of 1 June 1948, a parliamentary council, which convened at Bonn early in September 1948, drew up a basic law, in lieu of a formal constitution, for the new western German Federal Republic. The Federal Republic includes all three west German occupation zones and replaces the bizonal economic control mechanisms established in June 1947. After the formal approval of the Bonn Constitution on 23 May 1949, elections were held throughout west Germany on 14 August, and the new government was formally established in September 1949. On 21 September, Military Government came to an official end, and supreme authority in western Germany was assumed by the Allied High Commission, composed of a civilian High Commissioner from each of the western occupation powers. By the establishment of a unified but federalistic west German Government, and with the spheres of Allied and German responsibility delimited in an Occupation Statute, the Western Powers hope to advance German political maturity and stability and economic recovery as part of the general program for reviving and strengthening Western Europe.

The emergence of Berlin as the principal point of tension between the USSR and the western Allies has greatly modified the character of the government of that city. The Soviet blockade, begun in June 1948, was countered by the US/UK airlift for the supply of the western sectors from 26 June 1948 to 30 September 1949. The breakup of quadripartite control, which followed the institution of the blockade and airlift, resulted ultimately in a complete division in the city administration. This division was climaxed by the establishment of a Soviet-controlled east Magistrat, and the election of a new SPD-dominated west Magistrat five days afterward on 5 December 1948. The western-sector city government, although handicapped by straitened finances and the gradual paralysis of west Berlin's economic life, has nevertheless continued to provide effective government. On 12 May, presumably as a result of the success of the airlift and the firm resistance of the Western

Powers and the west Berlin population to Soviet pressure tactics, the USSR lifted the blockade. After the Paris CFM meeting in May and June 1949, the military authorities of all four powers were directed to discuss the normalization of city services. To date, however, little has been achieved by these discussions, and Berlin remains substantially as it was before the CFM, although the once acute East-West tension has been eased considerably.

Economically, the damage to the vast industrial complex of prewar Germany left a void in central Europe of the utmost significance to US interests. For many years the German system was so closely integrated with the economies of other European countries that its impairment and dislocation has thrown the old order of things badly out of balance and forced an uneconomic reorientation of European trade, commerce, and industry. The countries of Western Europe have had perforce to depend upon the US, in the absence of their former German markets or sources of supply, as the only nation capable of supplying required goods. The economies of Eastern Europe, on the other hand, are under the domination of the USSR, which operates on entirely different principles, as a consequence of which economic activity is directed toward attainment of political objectives rather than toward maximizing incomes. Consequently, Germany has become a land across which normal travel and trade are very difficult.

From the outset of the occupation the Allied powers pursued divergent economic as well as political policies in Germany. The USSR methodically stripped the Soviet Zone not only of its war potential but also of a good deal of its industrial capacity by a rigorous policy of reparations, dismantling, exports of raw materials and consumer goods on the Soviet account, expropriations, and confiscations. What remained in the zone was not sufficient to meet the minimum needs of the population, which has been exploited systematically for the benefit of the occupying power. The USSR later reversed this policy and built up basic industries, while private enterprise was consistently discouraged if not eliminated in many fields. Most of the production was sent

to the USSR as reparations. State-owned enterprises receive heavy subsidies from the German *Laender* under Soviet direction, and their uneconomical operation is a heavy drain upon the zonal economy. Soviet land reform disorganized zonal agriculture and produced serious food crises in what was once a surplus agricultural region in prewar Germany. Nevertheless, the USSR has maintained an industrial production level satisfactory for its own purposes, compensating for shortages and other production difficulties by intensifying the exploitation of German labor. Since the good harvest of 1948, the USSR has been able to increase considerably the basic ration as well as the amounts of food flowing into the state-owned "free shops." The Allied counterblockade established in July 1948 aggravated internal difficulties somewhat and compelled the USSR to postpone integration of the Soviet Zone economy with the satellite region until the Zone could occupy a stronger economic position to support Soviet policies. Industrial expansion under the Two-Year Plan of the German Economic Commission (DWK) of the Soviet Zone is expected to effect improvement in the zonal economy, in conjunction with increasing trade with the countries of Eastern Europe.

In the western zones France, in the past, followed an economic policy somewhat similar to that of the USSR although on a less impressive scale. The French occupation forces lived off the land, and French expropriation of German industry was carried on in a variety of ways. Consequently, economic recovery in the French Zone lagged far behind that of the Bizone and only substantial assistance under the European Recovery Program averted an almost total collapse. Under the terms of the trizonal merger, signed 18 October 1948, France began to align its policies with those of the US and the UK in the interest of an overall rehabilitation of western German industry and agriculture. Basic rations for the normal consumer were substantially increased, occupation costs adjusted to relieve the financial burden on the German *Laender*, and the export-import trade of the zone gradually integrated with that of the Bizone.

Upon the US has fallen most of the burden of reactivating the western German economy. War damage and the disruption of transportation facilities had brought industry almost to a standstill at the beginning of the occupation. The influx of displaced persons increased the population 25 percent and created a critical food problem with which the depleted agricultural resources of western Germany could not cope. Heavy imports of food and essential raw materials were required to keep the economy operating on a bare subsistence level. Despite these efforts, little improvement was effected during the first three years of the occupation. Export trade had practically disappeared, money had lost value, and barter became the principal means of commercial intercourse. Under such conditions, key industries could not be rehabilitated, and most consumer goods were unprocurable except in the black market. German discontent as a result of this economic stagnation and the punitive policies of the Allies culminated in a series of protest strikes and demonstrations in 1947 and early 1948. The June 1948 currency reform furnished the Germans with an incentive to cooperate in raising the general level of their economy in line with the European Recovery Program, under the stimulus of considerable ECA assistance. Greater economic responsibility was accorded the Germans, and the next nine months witnessed a marked increase in industrial productivity, export trade, and domestic sales. The general shortage of investment funds, which also resulted from currency reform, began after March 1949, however, to result in a temporary stagnation of the west German economy.

In its present relatively helpless condition Germany presents no military threat to the US, although the extent to which the war spirit has been chastened by defeat or by the postwar Allied policies of denazification and demilitarization is problematical. The country still possesses considerable war potentials in manpower, natural resources (principally coal), production facilities, and the technical skill and ability that can be utilized in war preparations by such a power as the USSR if bent on military aggression. As the major

SECRET

point of contact between the policies and physical forces of the US and the USSR, Germany plays an important role in the East-West struggle and is of utmost strategic significance to the US. Although the European aid program appears to have given the western Allies the advantage in the "cold war" for Europe, the remoteness of the US from the scene of ideological conflict, the propinquity of Soviet military power, and the still unsettled political and economic condition of Western Europe make uncertain the outcome of the struggle between democracy and Communism. So far the German people have shown no disposition to welcome Communism or the reappearance of a dictatorship, this time controlled from Moscow. The presence

of strong nationalistic elements hostile to occupation policies and confident of coming to an eventual arrangement with the USSR poses more of a threat to democratic institutions in western Germany than does any actual danger from Communist infiltration.

While it is improbable that the USSR will resort to war as a result of conditions in Berlin or elsewhere in Germany, the USSR has 375,000 troops stationed on German soil, or nearly twice the number maintained in Germany by the western Allies. Moreover, the Soviet Zone has organized a police force, including para-military police, to supplement the strength of the Red Army in the event of hostilities.

SECRET

CHAPTER I

POLITICAL SITUATION

1. Genesis of the Present Political System.

Total defeat in 1945 left Germany a political vacuum. With the destruction of the Nazi state, few vestiges of the former highly centralized autocratic German Government were allowed to survive. Instead, Allied decentralization policies were directed toward developing local and state governments in the different zones of occupation. Deriving their powers from the occupying authorities, these governments reflected to a great degree the political objectives of the local occupying nations in their respective spheres of influence, rather than the historic German political system.

This system was initiated by Bismarck, who welded the independent German kingdoms and principalities into union with Prussia in 1871, largely as a result of the Franco-Prussian War. This union was by no means one of equals, because Prussia preserved its semi-feudal, militaristic, and autocratic governmental system intact and extended these features to the other German states, which were compelled to acknowledge Prussian primacy in what became the Empire or Second Reich. The constitution of the Second Reich was constructed in such a manner that no measure objectionable to the Prussian Government could ever become law. This constitution did not express the popular will, but was a grant from the rulers of the various states to the Hohenzollern King of Prussia as Emperor and War Lord of a united Germany. In addition, the Imperial Chancellor was not responsible to the popularly elected German

Parliament (*Reichstag*), but to the Emperor. As Minister-President of Prussia and President of the upper house or *Bundesrat*, the Chancellor also greatly influenced parliamentary actions. Furthermore, Prussia exercised an absolute veto in the *Bundesrat* upon any constitutional change, another barrier to the development of liberalism or democracy in Germany.

Because of the nature of Bismarck's political system, inevitable conflicts developed which could not be resolved by parliamentary or democratic means. The dominance of the Prussian Army and the Junker class caused much discontent, but the Iron Chancellor pursued a repressive course toward all opposition elements, such as the Socialists, the Catholics, the trade unionists, and the proletariat. The Prussian Junkers and the great industrialists, which were the chief groups for providing and selecting the personnel of the officers' corps, worked in close alliance to control the machinery of government, the press, and the pulpit. They also carefully supervised and strictly regulated the educational system in their own interests. The vast bureaucracy resulting from such close control of all phases of German life became a paternalistic type of government. Bismarck's determined opposition to any extension of parliamentary government in Germany deprived political parties of all responsibility for the policy of the state and reduced them to the inferior status of pressure groups.

Bismarck's disappearance from the scene in 1890 did not alter the basic trends within the state. In fact, these were accelerated in

Note: The intelligence organizations of the Departments of the Army, Navy, and the Air Force have concurred in this report. For a dissent by the Department of State see Enclosure A, following page V-3. The report contains information available to CIA as of 1 September 1949. The Summary and Chapter II "Economic Situation" are in preparation and will be distributed, when completed, to holders of this report with appropriate notation of agency action.

some respects, particularly with regard to Pan-Germanism, militarism, industrial expansion, and imperial rivalries over trade and colonies. The new Kaiser, Wilhelm II, was young, rash, and egotistic. By his opposition to infringement of his royal privileges or those of the militaristic class which surrounded him, Bismarckian inflexibility of purpose was replaced by royal instability, with vastly important consequences for Germany both at home and abroad. The Kaiser's early liberal impulses proved superficial, and the monarchical-feudal character of German society was little affected by political agitation for reform despite the rapid growth of trade unionism, which became more a manifestation of discontent than an effective agency for improving the condition of the masses. The Socialists achieved few real gains through their own efforts before the first World War. The only effective part of their program was that borrowed by Bismarck, such as the Sickness Insurance Law, the Accident Insurance Law and the Old Age Pension Act, which were adapted to the purposes of the Prussian State. The power of the industrialists, the influence of the military circles in which the Kaiser moved, and the fascination of an aggressive foreign policy that would satisfy the national desire for expansion dominated the political situation and ultimately brought Germany into conflict with every European power that stood in its way. To overcome by military force the encirclement of Germany by hostile powers became the avowed objective of imperial policy and led directly to the first World War.

The immediate cause of the war was Germany's support of Austrian pretensions in the Balkans in the face of rival Russian aspirations. France and Belgium were invaded as preventive measures, and in the general conflict that ensued all parties and classes in Germany supported the Imperial Government, the Socialists joining with the Junkers in voting the necessary war measures. As the German military position deteriorated, disillusionment and unrest threatened the stability of the political system to such a degree that it was held together only by the military dictatorship established by Generals Hinden-

burg and Ludendorff in 1916. Ministers and civil officials were appointed or dismissed according to the requirements of military policy, and repression of civil liberties became complete despite the emergence of a democratic coalition in the *Reichstag*. This coalition, however, was powerless to exercise the slightest influence on the course of events and merely voiced cautious disapproval of unpopular measures. So passive and futile was the opposition to the military clique that, when total collapse was imminent in 1918 in the closing days of the war, it was the German High Command which suddenly turned the imperial system into a parliamentary democracy in the hope of appeasing the Allies and gaining a "soft" peace based on President Wilson's Fourteen Points. In the face of unexpectedly severe Allied terms and a rapidly deteriorating political situation within Germany, Ludendorff resigned, the Kaiser abdicated, and the militarists surrendered their political power. With the monarchy overthrown by revolution, the onus of making peace fell upon the provisional Social Democratic Government headed by Friedrich Ebert.

The period between the announcement of the Republic and the attainment of relative political stability was marked by Communist uprisings in the major German urban areas. The German masses, however, were unprepared for a social revolution on the Soviet model. The Communist-led "Spartacists" and their following were ruthlessly liquidated by the Socialist authorities with the assistance of the Free Corps, roving bands of former military personnel and riffraff. The Free Corps units were supported and financed by the big industrialists and the army for the purpose of liquidating opposition to the militarist-industrialist clique fighting for control of the Weimar Republic. From these Free Corps came the rank and file of the Nationalist movement, which furnished Hitler with the nucleus for his Nazi Party.

The German Republic had its basis in the constitution drawn up by the National Constituent Assembly at Weimar and put into effect in August 1919. It turned the old Empire, formally at least, into a fully democratic, federalistic state. The President was elected

by a popular plebiscite, while the *Reichstag*, to which the Chancellor and the Ministers were responsible, was chosen on the basis of universal suffrage. The old particularism of the states, now called *Laender*, was greatly reduced by the widened scope of Reich legislation. The predominance of Prussia was greatly reduced by changing the old *Bundesrat* into a *Reichsrat* of limited powers. All the basic democratic rights, such as freedom of speech and freedom from arbitrary arrest were secured in the Weimar Constitution. A provision was inserted, however, in Article 48 which enabled the authorities to suspend these constitutional guarantees in times of national stress or peril.

The Weimar Republic endured many vicissitudes before its extinction at the hands of the Nazis. The German party system, from lack of experience and responsibility in government, was unable to provide the leadership necessary to carry the country through the stormy postwar period. Parties representing outmoded interests could not obtain clear majorities in the *Reichstag*, and party leaders were forced to manipulate combinations or coalitions of uncooperative and unstable groups which were constantly dissolving and reforming at every governmental crisis. The Republic was harassed not only by war debts, postwar inflation and instability, but also by the odium of having ratified the Treaty of Versailles, to which the nationalists attributed all the ills afflicting Germany. This situation was fully exploited by the Right, which included the landowners, the industrialists, and the militarists, who were attempting to regain their old mastery over the state.

Although the Weimar Government was strong enough to suppress the various *putsches* instigated by its enemies, including the abortive attempt by Hitler in 1923, it was forced to compromise with reactionary elements in order to survive. Powerful industrial combines multiplied with direct assistance from the state; liberal subsidies were granted to the big landowners; no effort was made to suppress the many para-military organizations which were rapidly rehabilitating the *Reichswehr* system in violation of the terms of the Treaty of Versailles. Relative

prosperity was temporarily restored by the Dawes Plan, regulating the reparations question, and by huge loans from the United States for reconstruction. Political concessions were also obtained from the Allies, such as German admission to the League of Nations and the withdrawal of the Allied Commission on control of German armaments. By such means the Republic was able to survive until the world-wide depression of 1929-30.

A succession of Cabinets (Bruening, Papen, Schleicher) ruling (1929-32) by decree without parliamentary support proved unequal to the task of solving the economic crisis. The German middle classes, on which a parliamentary democracy would normally have relied for support, and, to a lesser extent, the working classes now succumbed to the pressure of world conditions while foreign trade and loans dwindled rapidly, production dropped, wages declined, and employment fell off sharply. The government was unable to check the economic landslide, unemployment swelled the ranks of reactionary forces inimical to the Republic, and extreme nationalists of the Hugenburg-Hitler type redoubled their propaganda attacks on the Weimar regime. In the 1930 elections the Nazis, who in 1928 had secured only 12 seats in the *Reichstag* with 810,000 votes, were supported by over 6 million voters and increased their representation to 107 members, second only in size to the Social Democrats. The Communists, moreover, assisted the Nazis in provoking disorders to hamper the government's efforts at recovery. As conditions grew steadily worse, the Nazis swept the 1932 elections and emerged as the strongest party in the *Reichstag*. After an interval of palace intrigue, the aged President von Hindenburg was induced to appoint Hitler Chancellor in January 1933.

Hitler lost no time in converting Germany into a totalitarian state. The *Reichstag* fire of February 28 furnished a pretext for liquidating the opposition. A month later the *Reichstag* surrendered its powers through the "Enabling Act" which conferred supreme power on the Cabinet; henceforward Hitler ruled by decree and the *Reichstag* was merely summoned with the rest of the populace as an audience for his harangues. In 1934 Hitler succeeded

Hindenburg as head of the state. The army took a personal oath of allegiance to him, and the Reich Ministers followed suit a little later.

In May 1933 the trade-union movement was broken and absorbed by the German Labor Front, an all-embracing Nazi organization of employers and employees, financed by compulsory contributions. In July 1933 the National Socialist Party was proclaimed the sole legal political party in Germany. Local government in both the *Laender* and the municipalities was severely circumscribed and all officials became appointive with little purpose but to apply Nazi law within their areas. Police powers were also transferred from the states to the Reich, and a vast network of secret police was spread over all of Germany. The Elite Guard or *Schutzstaffel* (SS) served with the secret state police (Gestapo), the Security Service (SD), and the Criminal Police (Kripo) of the Head Office of the Reich for Security (RSHA) to safeguard the Nazi state, acquiring in the process an infamous record. These agencies were most active and merciless in the extermination of German Jews and in the operation of concentration camps where mass murder and torture were practiced. The SS also had its own military organization separate from the regular army, and by 1939, it numbered 240,000 men, all fanatics dedicated to the Fuehrer's purposes.

Since 1871 the German people have been increasingly indoctrinated with nationalism. As Prussian influence and the Prussian bureaucracy became implanted in the rest of Germany, centralization of the government was heightened and federalistic elements correspondingly weakened. Successive defeats in two world wars have given rise among certain elements to federalist and anti-nationalist tendencies, which have found support in the policies of the western occupation powers. Centralism and nationalism remain nonetheless predominant in the outlook of the average German and will become increasingly active forces as control over their own destiny is returned to the Germans.

2. Present Governmental Structure.

The present political situation in Germany stems largely from the departure by the USSR from its limited wartime cooperation with the Western Powers. Pursuing an aggressive foreign policy, the USSR interpreted the Potsdam Agreement in a manner designed to further its efforts to gain control of Germany, and in successive CFM meetings the USSR proved adamant in its demands. Allied protocols on the occupation and control machinery for Germany were derived from the agreements among the occupying powers and provided for a Germany temporarily divided into four zones, each occupied and governed by one of the four powers: the US, UK, USSR, and France. In addition, it was agreed that the USSR and Poland should administer the area east of the Oder-Neisse Rivers. This has resulted in the complete separation of the area from post-World War II Germany.* An Allied Control Authority (ACA) was established at Berlin as a quadripartite governing body exercising suprazonal command. It was organized as three main functional bodies: (a) an Allied Control Council (ACC) consisting of the senior representatives of the occupation powers; (b) a Coordinating Committee, composed of the Deputy Military Governors of the zones; and (c) a Control Staff divided into 12 categories (Directorates), each with quadripartite representation. The Commanders-in-Chief in their respective zones were given executive, legislative, and judicial authority limited only by agreed policies of the four Powers. Unanimous decisions were required for measures affecting all of Germany.

Berlin was constituted a special international political district and divided into four sectors of occupation, each Power having authority in its own area, except in city-wide matters which were under the control of an Allied *Kommandatura*.

Potsdam political principles were not applied uniformly by the four Powers. The principles proved liable to such a variety of

* The so-called Polish Administration now incorporated into Poland is not considered an integral part of Germany in this report.

interpretations that unanimity of action was generally impossible. Consequently, examination of the manner in which the political principles of Potsdam were carried out requires an analysis of each zone separately.

The USSR sought a highly centralized administration susceptible to control directly or indirectly from Moscow and staffed with chosen personnel believed loyal to Soviet concepts. The UK has favored a federal union capable of providing an effective central administration without destroying the local autonomy of the *Laender*. British supervision was undertaken by its own Civil Service, and the UK, therefore, selected Germans for local administrative posts primarily for their efficiency rather than on the basis of their former party affiliations. France, with a profound distrust of all things German, desired the maximum degree of decentralization, preferably a loose confederation of small states on the pre-Bismarckian model; therefore, German assistance was relied upon to a relatively minor extent. The US, on the other hand, undertook from the lowest level the construction of local governments aimed at an eventual federal state similar to that sought by the UK, but without centralized planning and regulatory features. Because of a sweeping denazification program, the US experienced great difficulty in selecting and retaining competent German administrators, although conferring considerable freedom and authority upon those chosen in an effort to acquaint the Germans with the rudimentary processes of democratic government.

3. Political Parties and Current Issues.

Permission and encouragement for the creation of "democratic" political parties accompanied the building of appointive administrations. Soviet organizational efforts exceeded all others in an almost frantic desire to place Communist candidates in the most advantageous position regardless of their actual political importance or weight. US faith in the efficacy of free elections put the US Zone second in respect to the amount of organizational activity permitted the Germans. The UK did not retard the growth of parties but offered no substantial encouragement in spite

of sympathies with the Socialist movement in Germany. The French, distrusting any German political development, offered no positive assistance but merely abstained from suppressing any political elements not deemed dangerous. Nevertheless, certain relationships or similarities in party names and platforms appeared in all four zones. German leadership was for the most part under the influence of the local occupation authorities whose divergent political objectives have been the cause of much favoritism and discrimination among German political parties.

Four major political groupings appeared throughout Germany during the first six months of the occupation. They were the Social Democratic Party (SPD), representing for the most part the old trade-union movement of the Second Reich and the Republic; the Christian Democratic Union (CDU), which succeeded the old moderate conservative Centrist and People's Parties; the Liberal Democratic Party, or LDP, now the Free Democratic Party or FDP, an independent bloc slightly to the right of the CDU; and the Communist Party (KPD), a wholly Moscow-directed body that has exerted an influence out of proportion to its small size by means of superior organization and guidance as well as overt Soviet support. Minor splinter parties also developed. For the most part these rightist and nationalist groups still lack cohesion, but are gaining in strength and influence.

a. Soviet Zone.

The USSR has regarded the Soviet Zone as the stronghold from which Communism would spread over all Germany and as an exploitable source of industrial production. Soviet efforts to make the zone firmly Communist, as well as Soviet economic policies, have alienated the Germans in all zones so thoroughly that there is slight chance under present conditions that Communism will attract significant strength in Germany.

Since 1945 Soviet efforts to create a Communist-controlled regime for domination of the Soviet Zone and to neutralize general German hostility to the USSR have consisted of a series of measures which have all failed in their basic purpose of building up a control

system capable of surviving in the absence of direct Soviet support. The earliest move was the Antifa System (anti-Fascist Front), consisting of coalitions of the four major parties (the CDU, SPD, LDP, and KPD) at all governmental levels in the *Laender*, with the purpose of promoting jointly the "democratic" recovery of eastern Germany. Close Soviet control and manipulation of the KPD into a dominant position soon caused the non-Communist parties to lose interest.

The second phase of Soviet political policy was the creation of the Socialist Unity Party (SED), which was the prelude to the era of the "mass organizations" approach. Because of the KPD's inability to win the support of the working classes, the SMA forced the SPD in Soviet-controlled territory to merge with the KPD to form the SED. For the KPD this merger had three main effects: (1) it removed a rival for the support of the working classes; (2) by superimposing the Communist Party structure upon the SPD organization, the KPD acquired control of the largest party in the Soviet Zone; and (3) it opened the KPD organization itself to the infiltration of hostile Socialist elements and resulted in considerable decrease in party loyalty to the USSR.

The SMA ensured predominance of the SED in the Soviet Zone by providing it with every possible benefit while denying the CDU and LDP all but the most rudimentary propaganda and organizational facilities. Despite such methods and a carefully staged election, however, the newly formed SED was able to gain a bare 51 percent majority of the vote in *Land* and local elections in October 1946 only by including "Front" organization ballots and manipulating election totals. A CDU-LDP coalition was forbidden, and in some areas where the opposition had managed to elect officials, they were soon rendered ineffectual by SMA action in conferring greater power on local SED functionaries, who were placed in key positions in the local governments.

In addition to the SED, the SMA took considerable pains to build up a system of mass organizations to serve as support for the SED. Women were organized in the *Frauen Bund*, labor in the Free German Trade Union

League, youth in the Free German Youth and other groups. These mass organizations, intended primarily as propaganda vehicles to promote various programs of the SMA and to regiment various social groups under SED control were unable to attract genuine public support. During 1948 and 1949 most of them gradually dwindled in importance, except for the Free German Youth and possibly the Free German Trade Union League, while the SMA directed SED interest in other directions.

In the latter part of 1947, the KPD-SED having proved its inability to win over the working class and petty bourgeois in appreciable numbers, the SMA directed its tactics toward enlisting for the SED the support of German nationalism throughout Germany. The first manifestation of these new tactics was the People's Congress (*Volkskongress*), the revival under a new name of the defunct Antifa System. The main propaganda of the *Volkskongress*, however, was centered on withdrawal of all occupation forces and the creation of a unified "democratic" national German government. In addition several small pseudo-nationalistic parties were set up by German collaborators and in 1949, a Communist-inspired political movement called the National Front was organized under the leadership of the SED. The bankruptcy of Soviet policy designed to win German support was highlighted by the outcome of zonal-wide elections for the *Volkskongress* in May 1949, in which the announced opposition vote was one-third of the total polled vote, even after several days of manipulation of election figures by SMA representatives. A second blow to the SMA was the west German elections in August, which resulted in a high turn-out of the electorate and a further decrease in western KPD strength in spite of an energetic campaign in the Soviet-controlled press. SED and Soviet reaction to the formation of the Federal Republic has consisted mainly of vituperative propaganda with negligible effect in western Germany. In the Soviet Zone itself, preparation for the formalization as a government of the existing administrative and pseudo-parliamentary agencies has continued at an accelerated pace. The USSR is not expected to risk new elections, however,

SECRET

I-7

before it is assured that the outcome will be more in harmony with Soviet desires than in past elections.

As a further result of the failure of the Communist-controlled SED to gain popular support, the USSR began in the late summer of 1948 to push the creation of a control mechanism to supplement party controls, in the hope that this mechanism might eventually be capable of replacing the Red Army in maintaining the Communist regime. The control mechanism itself is divided into political-police controls, and a highly centralized economic agency. Through the Communist element in the SED and the German Administration of the Interior (GAI), the USSR has created, at least on paper, a political system with front organizations designed to organize the population thoroughly, and a centralized police administration modeled on that of the Third Reich.

Basic control is exercised theoretically through the all-pervasive influence of the SED, although Soviet security personnel are infiltrated throughout the control mechanism and local Soviet commanders have considerable authority.

The German Economic Commission (DWK) established in the summer of 1947 and activated in February 1948 has been highly centralized with direct vertical control over all zonal production, except for the Soviet Corporations (SAG's). Economic powers have been removed from the jurisdiction of the *Land* governments and given to the DWK.

The GAI and the DWK control respectively all police activity and all functions of the zonal economy. These agencies are supervised directly by the SMA. In addition the SED covers directly or indirectly all political activity throughout the zone, and through the party structure can influence SED personnel, who occupy all key positions within the two executive agencies; the SED is also directly supervised by the SMA either from Karlshorst or through local *Laender* SMA's.

At present the USSR keeps these control organizations almost entirely separated, except for high-level coordination by the SMA or the politburo of the SED. By continuing this policy, the USSR can better insure con-

trol and prevent the development of an integrated German state which might develop strong independent tendencies.

Because of the hostility of the German population to Communism and the USSR, it is estimated that the USSR will require a police control mechanism two or three times its present size of 100,000 * in order to police the Soviet Zone adequately in the absence of Soviet troops. The reliability of such a police force would be doubtful in the event of a Soviet troop withdrawal, because of nationalistic and anti-Soviet tendencies already becoming evident throughout the present control mechanism. The principal problem of the USSR is to find enough "loyal" Germans for adequate staffing of this mechanism.

b. UK Zone.

Since the UK Zone is the most highly industrialized area of Germany, with a long tradition of socialist trade unionism in connection with its industrial development, the UK has been faced with a number of politico-economic problems. Had there been any great degree of postwar economic stability, the growth of a socialist political body from workers' cells and union nuclei might have been comparatively simple; but the stagnation of industry and the consequent paralysis of trade union functions seriously hindered such a development. Moreover, the presence of a Labor Government in the UK, and the impatience of left-wing politicians at home with the slow implementation of their theories by the occupation authorities, had a pronounced effect upon UK occupation policies in Germany. It was inevitable, in spite of efforts to maintain the appearance of impartiality, that the Social Democratic group in the UK Zone would be the choice of an important segment of the UK Government because of supposed similarities to the British Labor Party.

In the UK Zone the two major parties in western Germany first developed, as well as a galaxy of splinter parties of varying political coloration. The SPD and the CDU were allowed to organize their party structures on a

* I.D. Dept. of Army estimate for 1 September 1949.

SECRET

zonal basis and soon extended their *de facto* authority to the less disciplined organizations in the French and US Zones. In addition to the SPD and CDU, the KPD has been most active in the UK Zone. Attracted by the extensive industrial complex and large concentrations of urban population, the KPD has been carrying on a continuous but fruitless campaign to wrest control of German labor from the SPD. KPD strength has continually declined, as the party has been obliged to endorse the unpopular policies of the USSR in eastern Germany and to conform to every twist in the party line. In addition, numerous right-wing parties are constantly appearing on the scene, merging with others of similar nature, or fading away. The German Party (DP) appears at present the most likely of these groups to achieve any lasting success.

In the UK Zone, acceptable and vigorous leaders emerged from the political wreckage sooner than in the others. Two of these leaders, Kurt Schumacher of the Social Democrats and Konrad Adenauer of the Christian Democrats, served as rallying points for their followers throughout Germany and made UK Zone politics almost a matter of personalities. When elections were finally organized and approved in the UK Zone, the complex electoral procedures laid down confused the Germans thoroughly. Under electoral regula-

tions, an advantage was granted to the strongest party in any locality, and while the system may have been intended to reduce the tendency of German parties to "splinter," it operated considerably to the advantage of the British-favored SPD in a close contest with the CDU. Neither was able to gain a clear-cut victory in the 1947 *Land* elections. The SPD obtained a majority in Schleswig-Holstein, but only a plurality in Lower Saxony. In the largest west German *Land*, North Rhine-Westphalia, the CDU gained a plurality.

In the national elections of August 1949 for the Federal *Bundestag* (lower house) the CDU received a plurality in North Rhine Westphalia and Schleswig-Holstein, while in Lower Saxony and Hamburg the SPD won a plurality. In all *Laender* the struggle between the CDU and SPD was relatively close. The Free Democrats made substantial gains, as well as local parties of varying political complexion. The KPD continued its downward trend, losing strength in all *Laender*. Because of the complex electoral law, party representation in the *Bundestag* did not always conform to the party's percentage of the polled vote, the smaller parties being somewhat handicapped. On a *Laender* basis party representation from the UK Zone is the following:

	<i>North Rhine- Westphalia</i>	<i>Lower Saxony</i>	<i>Schleswig- Holstein</i>	<i>Hamburg</i>	<i>Total</i>
Christian Democratic Union	43	12	8	3	66
Social Democratic Party	37	24	8	6	75
Free Democratic Party	10	5	2	2	19
Communist Party	9		1	1	10
German Party		12	3	1	16
Independents			1		1
Center Party	10				10
South Schleswig Association			1		1
German Rightist Party		5			5
Total	109	58	23	13	203

With the US-UK bizonal merger, the active interest of the US in German economic conditions lessened the attraction of socialism. German workers could expect better living conditions as a matter of course, thus impair-

ing the appeal of labor unions, which now occupied a somewhat anomalous position. The unions could obtain nothing substantial for the workers because they were powerless to enforce their demands against MG authority.

British advocacy of industrial socialization was put aside, out of deference to the US position. The creation of the International Authority for the Ruhr not only practically removed the Ruhr from German governmental control, but also effectively blocked SPD hopes for socialization, at least for the predictable future. This situation has possibilities from which the CDU or some other yet unorganized political group may yet profit.

c. French Zone.

Security has been the key to French behavior in all matters relating to German politics. Two major points are distinguishable in France's policy toward Germany as a whole: the first aims to prevent Germany from again waging war against France; the second seeks to prevent any international action in respect to Germany that might precipitate a war with the USSR.

Politically, therefore, the French opposed any unification of the four zones of Germany without strict Allied control for an indefinite period; they opposed the withdrawal of Allied troops or even a relaxation of Allied controls, without definite tripartite or quadripartite agreement; they insisted that Allied troops continue to occupy certain key points for an indefinite time; they opposed the creation of a centralized government in Germany, preferring a weak federation of the states.

On the economic side, the French insisted on the Allies' retaining control of the Ruhr. Their purpose was to insure that Ruhr coal production is regulated in the interests of French industry, and to prevent the revival of a German heavy industry which would be in competition with the French economy or dangerous to French security.

As a result of US and UK determination to create a relatively stable political and economic regime in western Germany, however, the French were obliged to modify their position. Beginning with the tripartite London Decisions of June 1948 the French were persuaded through a series of tripartite conferences into agreeing to the economic and political merger of the French Zone with the Bizone to form a trizonal area with a German government of some degree of autonomy.

The French have not been in a position to exert any substantial influence in Germany since 1933, and their capabilities are unlikely to change naturally in the future. For this reason, the French insisted, in tripartite conferences, on the maximum amount of long-term controls over western Germany that they could obtain from the US and UK. Since the various tripartite control organizations, such as IAR and the Military Security Board, were set up, the French have been attempting to gauge whether the US and UK intend to fulfill these agreements in spirit or in the letter, and can be expected to object strenuously if the US and UK use the newly formed High Commission for functions which the French would prefer to assign to one of the other control organizations. Any trend toward allowing the various control boards to atrophy from lack of use will also arouse considerable protest on the part of the French.

French policy in Germany was almost completely negative during the period between the end of the war and the tripartite London Conference of June 1948. The political parties were kept on a localized basis as much as possible, and contacts with party organizations in the other three zones were discouraged, if not forbidden. The German administrations for the area were also relatively isolated and directly controlled by the French authorities. The predominantly Catholic CDU and the SPD were the only parties of any significance to develop; the CDU exhibited some separatist tendencies, and the SPD was relatively weak. As a result, relatively little German opposition to the French developed. Communist strength has been particularly weak in the French Zone.

Following the tripartite London Conference of 1948, the French gradually relaxed their controls and allowed the political parties and labor unions to strengthen their ties with similar organizations in the bizonal area. The SPD is now allowed to operate with relative freedom under the guidance of the Party Directorate in Hannover, and the CDU has passed under the titular leadership of Adenauer. The labor unions are in process of merging with their bizonal counterparts. In the national elections for the *Bundesrat* the

CDU led in all *Laender* of the French Zone, followed by the SPD, KPD, and the *Samm-lung Zur Tat*, a new political party of dubious character.

In *Bundestag* seats, the outcome was the following:

	Baden	Wuerttemberg- Hohenzollern	Rhineland- Palatinate	Total
Christian Democratic Union	7	7	13	27
Social Democratic Party	3	2	7	12
Free Democratic Party	2	1	4	7
Communist Party	—	—	1	1
Total	12	10	25	47

d. US Zone.

The strict implementation of the denazification program in the US Zone made initial political organization there especially difficult. Many non-Nazis were either too far to the left or else were stigmatized by their connection with the discredited Weimar regime. Although acceptable leaders were difficult to find, the four major parties (the SPD, CDU, LDP, and KPD) proceeded with their organization as soon as MG permission was granted. Such leaders as came forward became involved in bitter inter- or intra-party feuds.

The Germans accepted their major parties largely on the grounds of class and religious preferences. In the *Landtag* elections of 1946-47, the CDU with Church support showed great strength in the Catholic rural regions of the south, while in the northwest and in urban or industrialized areas the SPD took the lead. In the US Zone at large the CDU (or Christian Social Union as the party is known in Bavaria, where it obtained a majority position) achieved a slight superiority at the polls over the SPD. The few particularist organizations drew some strength from right-wing Liberal or Free Democratic groups, but these had no strong leaders and were at that time so weak that no real alteration in the general political picture resulted. The Communists made a remarkably poor showing ex-

cept in such industrial areas as Frankfurt and Munich.

Despite pre-election prophecies of German political apathy because of public pre-occupation with the daily struggle for existence, a high percentage of eligible voters went to the

polls in these elections, the first under the occupation. There was surprisingly little abuse of the electoral privilege, although lack of familiarity with the new procedures may account for the absence of corruption or manipulation of the electoral machinery to date. Political leadership assumed responsibility for the creation of *Land* and local governments, and the struggle for positions at the top has gone on, although limited by consideration of the shadowy nature of the authority conferred and the possible blame which might, at some future time, be attached to such collaboration with the Occupying Powers. Blocs, cliques, and coalitions were formed; and while much of the maneuvering was directed at personal advancement, the public interest was not entirely neglected, and the best available men were generally retained in office. The constitutions adopted on the *Laender* level reflect the ingrained German predilection for granting extensive power to leaders. US guidance was confined largely to insuring that such controversial issues as socialization be given individual consideration by the voters, and that directives of Military Government be obeyed.

In the recent elections for the *Bundestag* the relative positions of the political parties did not change greatly except for a considerable loss of strength in the Bavarian CSU.

SECRET

I-11

Bundestag representation from the US Zone is as follows:

	Bremen	Bavaria	Wuerttemberg-		Total
			Baden	Hesse	
Christian Democratic/ Christian Social Union	1	24	12	9	46
Social Democratic Party	3	18	10	13	44
Free Democratic Party		7	7	12	26
Communist Party			2	2	4
German Party	1				1
Independents			2		2
Bavarian Party		17			17
Economic Reconstruction Party		12			12
Total	5	78	33	36	152

Western Zonal Mergers and the West German State.

Because of quadripartite failure to implement the Potsdam Agreement in treating Germany as a single economic unit the US on 20 July 1946 proposed an economic fusion of its zone with all or any other zones. As a result, the US and UK effected an economic union of their two zones on 1 January 1947, the USSR and France having rejected the proposal with respect to their zones. The bizonal area was supervised by the Bipartite Board, consisting of the US and UK Military Governors, and the Bipartite Control Office, consisting of their deputies and representatives. The German agencies in the new administration were the Executive Joint Committees, each of which consisted of eight German representatives, one from each of the *Laender* in the two zones. By the spring of 1947, a reorganization of these German agencies became necessary in order to eliminate weaknesses which had developed in the course of their operation. There was a serious lack of coordination among the committees and an absence of popular representation which resulted in political antagonism and parliamentary hostility. An agreement was therefore concluded on 29 May 1947 establishing a bizonal organization on a representative basis and giving it considerable additional powers.

A Bizonal Economic Council was created and charged with the responsibility of directing the economic reconstruction of the two zones subject to the approval of the Bipartite Board. The function of the Council was to adopt and promulgate ordinances in the fields

of economics, finance, transport, communications, food and agriculture, and the civil serv-

ice management of bizonal department personnel. Members of the Council were selected by the *Landtage* of the various *Laender* on the basis of one to each 750,000 population, thus giving the Council fifty-two members. In addition to the Council, an Executive Committee was created, composed of one representative from each *Land* appointed by the *Land* Government, to propose and make recommendations on ordinances to be adopted by departments which took the place of the Executive Joint Committees. These directors operated under the immediate supervision of the Executive Committee but were responsible to the Economic Council for the management of their departments. Ordinances adopted by the Council and approved by the Bipartite Board were superior to any other German legislative enactment and binding upon all the *Laender*.

In actual practice, the performance of the Bizonal Economic Council proved disappointing. No single party in it had a clear majority, and most of its time was occupied with political maneuvering between the SPD and the CDU. Moreover, the Council had a tendency to be preoccupied with legislation outside its immediate province and unacceptable, therefore, to Military Government. Sectional conflicts developed to such an extent that the *Laender* frequently defied the authority of the Council or ignored its recommendations. Consequently, the necessity for strengthening the economic structure and broadening the political basis of the Bizonal Economic Council led to its reorganization on 9 February 1948. The membership was doubled; each *Land* was

SECRET

given at least two representatives; a *Laender-rat* or upper chamber was created and given coordinate power in legislation; the Executive Directors became in essence a Cabinet working under a chairman, and other agencies such as a *Bank Deutscher Laender* and a German high court were established. Closer integration of the functions of government was expected to improve the peaceful productivity of western Germany and to leave as much responsibility as possible for this purpose to the Germans.

Before the new organization had an opportunity to prove its effectiveness, the critical economic situation in western Germany as well as the obstructive attitude of the USSR following the failure of the London Conference of Foreign Ministers in December 1947 to consider the German question as a whole, caused the western Allies to consider on a tripartite basis the question of supplanting the administrative framework in western Germany with a provisional government, which could be brought into relation with the democratic countries of Western Europe as a part of the general program of European economic rehabilitation. To this end a tripartite conference was held in London in February and March 1948, in which the Benelux countries were invited to participate, for the purpose of discussing the rebuilding of western Germany and the creation of an international authority for the Ruhr. In order to make a closer study of such matters as the setting up of the tripartite machinery, the coordination of economic affairs between the Bizon and the French Zone, foreign trade, and the future political organization of western Germany, working parties were established on the Military Government level in Germany, and reported their findings to the Tripartite Conference when it reconvened in London on 20 April 1948. In the meantime the USSR had taken strong exception to the policy of the western Allies as it related to a western German government, in consequence of which Marshal Sokolovsky walked out of the Allied Control Council in Berlin on 20 March 1948 alleging that unilateral western Allied action ended quadripartite control of Germany.

On 1 June 1948, the Tripartite Conference adopted a series of recommendations, known as the London agreements or decisions, dealing with various phases of the German question. Among other things, the Military Governors were authorized to call a joint meeting of the Ministers President of the eleven western German *Laender* and instruct them to convene by 1 September a constituent assembly that would prepare a democratic constitution for ratification by the participating *Laender*. The joint meeting was delayed by the implementation of currency reform in western Germany, and by the action of the French Assembly in approving by a narrow margin the London decisions with reservations designed to safeguard French security interests with respect to the Ruhr. German reaction to the London decisions was distinctly unfavorable, the consensus of all parties being that the proposed government would have the effect of irreparably splitting the country into Communist and non-Communist-controlled areas and that economic rehabilitation should precede attempts at political reconstruction. These views were reflected by the Ministers President at the joint meeting with the Military Governors on 1 July 1948, at which time the Germans were presented with the Allied proposals regarding: (a) the preparation of a German constitution; (b) a possible adjustment of *Laender* boundaries to meet the requirements of territorial representation; and (c) the details of a contemplated Occupation Statute defining the powers of German self-government and delimiting the spheres of Military Government control.

The Ministers President considered the Allied proposals at a series of conferences at which considerable opposition to their acceptance developed, and then submitted a series of counter-proposals on 15 July 1948. Most of the German delegates wanted a federal government which would leave an opening for eventual reunion with the eastern *Laender*. They also emphasized the desirability of maintaining the provisional character of the new regime and opposed the use of the terms "government" and "constitution" lest the USSR react unfavorably and take retaliatory measures that would destroy all possibility of an

SECRET

I-13

ultimate unification of Germany. The Military Governors were prepared to meet the German objections to the extent that they did not infringe upon the London agreements, and at another joint meeting on 26 July with the Military Governors, the Ministers President agreed to accept this arrangement and proceed with the preliminaries incident to the calling of a constitutional convention. The *Landtage* of the eleven western *Laender* then went ahead with the election of representatives to the temporary assembly, which met on 3 September to draft a constitution along the lines laid down in the London agreements. These called for the establishment of a governmental structure of the federal type to be ratified upon completion by a referendum requiring approval by two thirds of the *Laender*.

The Bonn Parliamentary Council, consisting of 65 delegates under the presidency of Konrad Adenauer, debated constitutional questions for nine months before reaching agreement after many deadlocks and subsequent compromises between the strong centralistic tendencies of the SPD and the federalistic principles of the CDU. A constitution, or basic law, of 146 articles was adopted 10 May 1949 following receipt from the western Military Governors of an Occupation Statute delimiting respective spheres of authority between a German government and the Occupying Powers. Ratification was quickly obtained from the *Landtage* of all *Laender* except Bavaria, where strong separatist tendencies prevail, and the constitution was promulgated at Bonn on 23 May 1949. It provides for a Federal President elected by a Federal Convention but having little power, a Federal Chancellor or Prime Minister to head the Federal Administration, and a Parliament of two houses - a *Bundestag* popularly elected and representing the people and a *Bundesrat* or Council chosen by the *Laender* and having limited veto power over legislation initiated by the *Bundestag*. All powers are carefully divided between the Federal Government and the individual *Laender*. Although federal laws are binding on the states, and the Federal government has supervision over their execution, in most instances such

execution depends on the states, which thereby also retain decisive authority. The Bonn constitution closely parallels that of the Weimar Republic in many respects and retains the provision for emergency legislation by which the federal President can legislate by decree in the event of a serious controversy or disagreement with Parliament.

On 14 August 1949 elections for the *Bundestag* were held throughout western Germany. Voting generally followed the pre-Nazi pattern and although no party won sufficient seats to form a government, the election was in general a conservative and right-wing victory. The CDU won the largest number of seats, followed by the SPD, the FDP, and various smaller parties. The Communists continued their downward trend and failed to carry an electoral district, but as a result of the working of the electoral law were able to win some seats on the *Land* lists. The basic issue in the elections appears to have been that of a relatively free enterprise system versus a socialist planned economy. The manifest difficulties of the Labor Government in the UK and a relatively sterile campaign approach on the part of the SPD appear to have been the main reasons for SPD failure to make a more substantial showing. Party representation in the *Bundestag* is as follows:

	<i>Total seats in Bundestag</i>
Christian Democratic/Christian	
Socialist Union	139
Social Democratic Party	131
Free Democratic Party	52
Communist Party	15
Bavarian Party	17
German Party	17
German Rightist Party	5
South Schleswig Association	1
Economic Reconstruction Party	12
Center Party	10
Independents	3
	<hr/>
Total	402

On 7 September 1949, the *Bundesversammlung*, composed of members of the *Bundestag* and an equal number selected by the *Landtage*, met at Bonn and on the twelfth elected Theodor Heuss President of the Federation. Following Heuss's election, the *Bundesversammlung* was dissolved and the

SECRET

Bundestag met to consider nominations for the post of Federal Chancellor. On 15 September Adenauer's nomination was confirmed by 202 votes of a possible 402, a majority of one vote. The coalition which Adenauer formed consists of the CDU/CSU, the FDP and the German Party. The coalition has a scant working majority and is unlikely to function very effectively because of conflicts between its components. The principal problem involved will be the reconciliation of centralist and federalist viewpoints, an obstacle which in the long run is likely to wreck the present coalition.

4. Other Influential Groups.

The most significant development outside the political arena has been the growth of trade unions in the various zones of occupation.

In the Soviet Zone the USSR permitted the trade unions to organize soon after the fall of Berlin, expecting that the labor movement would go Communist. Trade unionists and organizers were given considerable assistance, whenever possible. The outcome, however, was that almost all unions were controlled by the Socialists, and in spite of Soviet pressure, Communist influence was either slight or non-existent. To remedy this situation and to centralize control of the unions in the hands of a small minority, the FDGB (Free German Federation of Trade Unions) was created and superimposed on the existing union structure. This organization quickly assumed, chiefly through pressure exerted by the Soviets, the powers which had formerly belonged to the individual unions. Coupled with this step, the USSR also used the forced merger of the SPD and KPD, forming the SED, to break what little power the former SPD union functionaries had been able to retain. Membership in some member unions of the FDGB was obligatory for all recipients of wages, salaries, and fees. The final step in stripping the unions of their power was the dissolution of the works councils, on the pretext that their functions were unnecessary in view of the existence of the FDGB. The result was the creation of a tightly knit, highly centralized, and pro-Soviet trade union

bureaucracy, controlling an apathetic or hostile rank and file.

Unlike western zone trade unions, which by comparison began only recently to operate on a zonal basis, the FDGB has been the zonal trade union authority since the early days of the occupation. Composed of nineteen constituent unions representing the various trades and professions organized vertically, its total membership in the Soviet Zone is about four million, roughly two-thirds of the total trade unionists in the whole of Germany. The functions of the FDGB far exceed those of normal labor organizations, so that representation of workers' interests is of minor importance. In addition to functioning as social security agencies, political and educational organizations, cultural and welfare bodies, the member trade unions have become an integral part of Soviet administration and assist in the preparation and execution of laws. Soviet benevolence, in the form of supplementary food and consumer goods allotments to union members, has been designed to enhance the prestige and popularity of the FDGB, but with slight success.

In the western zones, trade union activities have followed a different pattern in each zone, reflecting generally the occupation policies of the respective military governments.

In the French Zone, unions developed slowly. Organizationally, the various unions never developed beyond *Land* level, because of the French insistence on decentralization. Certain leaders gained considerable prominence and could, to a limited extent, exercise a zonal-wide influence. Since contact with union organizations in other zones was discouraged and the industrial complex of the zone is slight, and because French MG has continually interfered in union affairs, the French Zone unions remained weak and ineffectual until trizonal fusion became imminent.

In the US Zone, union organization was encouraged on a local level. Early in the occupation, works councils were formed and local unions organized. These local unions in turn expanded on a *Land* basis, but no centralized zonal headquarters developed, because of the US policy of encouraging the unions to develop from the lowest level, rather

SECRET

I-15

than vertically from the top. Until after currency reform in June 1948, wages and, to a lesser extent, prices were held down. Currency reform, however, practically emptied union treasuries. As a result, it was not until the fall of 1948 that the unions were in a position to bargain with management successfully. From the time of the bizonal merger in December 1946, the unions in the US Zone began to work closely with their counterparts in the UK Zone, and a Bizonal Trade Union Directorate was formed. The merging of the western German unions, however, really began only with the coming of trizonal fusion and the decision to form a West German government.

In the UK Zone, trade union developments followed a more considered pattern than in the other western zones. UK MG strongly encouraged union development under Socialist influence and encouraged the rapid creation of a centralized trade union structure as a mechanism for exerting some control over the unions and preventing Communist exploitation of the postwar chaos. As a result, the German Trade Union Federation (DGB) became the zonal organization, and represented the various member trade unions. UK Zone unions are the most powerful in western Germany, and will continue to be the dominant element in the west German trade union movement.

During the late spring and early summer of 1949, the organizational preparation for the merger of the trizonal trade unions progressed along lines parallel to the completion of trizonal fusion and the establishment of the new Federal Republic. Formal meetings for the purpose of completing the merger and creating an over-all west German trade union organization are scheduled for October 1949, and are expected to accomplish their purpose with little difficulty.

The trade union movement in Berlin reflects on a small scale East-West division of Germany. The Soviet-sponsored FDGB, as originally organized and controlled, was never acceptable in Berlin to the three Western Powers represented in the Berlin Kommandatura. The electoral methods devised by the SMA to insure the attainment and retention

of Communist leadership in the FDGB evoked repeated but vain protests on the part of the western Allies. Before the latter moved into Berlin to occupy their sectors, the USSR had already set up a trade union organization for Greater Berlin, subordinated to the Soviet Zone FDGB by a series of interlocking directorships. As Communist control tightened in the Soviet Sector, the original Socialist functionaries were weeded out and replaced by Communist and pro-Soviet personnel. The western sector branch of the FDGB, however, remained Socialist.

After having absorbed control of the east sector unions, the SED, through its representatives in the FDGB of Greater Berlin, attempted with considerable success to insinuate pro-Communists into the western sector FDGB bureaucracy. This policy was resisted by the Socialist leadership of the local member unions, but despite considerable internal bickering, no final split in the Greater Berlin FDGB occurred until May 1948. At that time, the Socialist leaders of the local unions, with the support of the western Military Governments, created the UGO (Independent Trade Union Opposition), in which all the hitherto latent opposition to the Communist FDGB leadership now crystallized.

Since the end of May 1948, when the UGO walked out of the Berlin FDGB, the Berlin trade union movement has been split along East-West lines. The UGO developed within the Communist-controlled FDGB and advocated an impartial stand on the East-West struggle over Berlin. When the FDGB city convention refused to recognize UGO delegates, almost all trade unions in the western sectors rebelled and set up their own trade union organization. Since the split, the Western Powers have protected and supplied UGO, while the USSR assisted the FDGB. UGO retained the character of an opposition group within the FDGB until 14 August 1948 when the eighteen trade unions affiliated with the organization decided to change the name to the Independent Trade Union Organization of Greater Berlin and become autonomous. The Berlin UGO now claims to be legal successor to the Berlin FDGB because of the subserviency of the latter to Soviet control.

SECRET

UGO's financial position, impaired by currency reform, has been strengthened by credit grants from Military Government, thus assuring UGO independence in competition with the Soviet-subsidized FDGB.

5. The Berlin Situation.

Following the breakup of the Allied Control Council on 20 March 1948, the USSR systematically accelerated its efforts to consolidate its grip on eastern Germany. New Soviet moves were made toward gaining unilateral control of Berlin, and an intensive propaganda campaign was waged to confuse the issues and shift the onus to the Western Powers. Progressively tighter restrictions were placed on communications, transport and commerce, aimed at cutting off Berlin's western sectors, from all contact with western Germany and Western Europe. These restrictions culminated on 24 June 1948 in the stopping by the SMA of all rail traffic into Berlin from the west, thus marking the start of the Berlin blockade.

Simultaneously, the Soviet authorities relentlessly harried the prowestern city government by unilaterally carrying out splits in the city police, the food and labor administrations, and public utilities departments. A "Democratic bloc," composed of various Soviet tools and front organizations, was created as the nucleus for a new city government to be set up after the expected withdrawal from Berlin of the Western Powers. Although the Allies did not withdraw, the growing split in the administration of the city affairs was finalized on 30 November 1948 by the setting up of a "rump" government in the eastern sector, under a Lord Mayor appointed by the SMA. Five days later, free city assembly elections in the western sectors resulted in a sweeping victory for the SPD. While the new city government, an SPD-dominated coalition of all the anti-Communist parties, no longer attempts to assert authority over the eastern sector, it provides effective and stable government for West Berlin.

The immediate pretext for the imposition of the Berlin blockade was the issuance on 23 June 1948 of the new west mark in the city by the Western Powers. The US/UK airlift

for the supply of the western sectors began three days later, expanding gradually until it carried a daily average load of well over 7,000 tons, sufficient to maintain an adequate food ration and limited industrial production. On 1 July, the Soviet Military Commandant refused to participate any longer in the meetings of the four-power Allied Kommandatura. As a result, the body continued merely as the supreme organ in Berlin of the three Western Powers. The USSR thereafter maintained that all Berlin is an integral part of the Soviet Zone, with Soviet Zone currency the sole legal medium of exchange for the entire city.

Throughout the blockade, the economy of the western sectors of Berlin deteriorated steadily. The decline in industrial production could not be arrested without normal transportation to the west, although some firms managed to survive through barter trade with Soviet Zone enterprises. Thousands of marginal or unessential businesses were forced to close down because of the acute shortages of fuel, electric power, and raw materials, and the rising cost of production, thus adding a serious unemployment problem to the burdens of the western city government. The economy and the municipal finances of the western sectors were in great part sustained at survival level by extensive loans from western Germany, which will eventually have to be repaid.

The financial problems arising out of the dual currency situation in west Berlin and the insufficiency of the west mark supply led on 20 March 1949 to the establishment of the west mark as the sole legal currency in the western sectors, together with an increase in the circulation of west marks in the city. Inability to solve the currency question on terms mutually satisfactory to the Western Powers and the USSR has been the chief factor in the failure so far to arrive at a compromise solution of the Berlin problem both on the quadripartite CFM level and in the United Nations.

In retaliation for the Soviet blockade of Berlin, the US and UK on 26 July 1948 suspended all railway traffic between the Bizone and the Soviet Zone, and subsequently all rail traffic originating in or transiting the Soviet

SECRET

I-17

Zone, as well as interzonal highway and barge traffic. This counterblockade intensified production difficulties in the Soviet Zone and disorganized attempts there to achieve a planned economy. The resources of the satellite areas proved insufficient to compensate for the loss of East-West trade. In an attempt to regain the initiative by reestablishing contact with the Western Powers and at the same time relax East-West tension, the USSR agreed to a simultaneous lifting on 12 May 1949 of all restrictions on traffic imposed since 1 March 1948, and a return to the situation then existing.

As a result of the Paris Conference of Foreign Ministers in May and June 1949, which did not itself achieve any definitive agreement on the divided city, the Berlin representatives of the four occupation powers were directed to confer periodically in an endeavor to bring about a normalization of conditions in Berlin. It was specifically stressed by the Western Powers that such meetings would in no sense constitute a renewal of the four-power Allied Kommandatura. Up to date, the meetings have produced agreement only on the recognition by both sides of each other's postal stamps for interzonal mailing purposes, and on a proposal that non-political experts from both east and west Berlin should meet to attempt a normalization of the city's public services, such as gas, electric light, and sewage.

Despite the relative normalization of rail, highway, and canal traffic between Berlin and western Germany since May 1949 (except for the period of slightly over a month when the strike of the western sector rail workers paralyzed all rail traffic around Berlin), the economy of the western sectors has continued to deteriorate. The inability of western Berlin manufacturers to compete with the lower

prices of producers in west Germany or of Soviet Zone producers is the chief cause of this continued decline, which has manifested itself in growing unemployment and plant shut-downs.

This economic paralysis has been paralleled by the increasingly unhealthy condition of the western sector municipal finances, resulting from the sharp rise in expenditures especially for relief to the unemployed and to firms damaged by the blockade, during a time when tax revenues could no longer be increased. The precarious finances of the Magistrat led the western occupation powers to insist upon a balanced city budget, which remains dependent in large part, however, on loans and subsidies from western Germany and the US. Now that the new Federal Republic is operating, demands are increasing among Berlin officials and the west German SPD that Berlin be frankly recognized as a deficit area requiring new and greater subsidies. The Federal Government is expected to provide continued aid to Berlin, although probably not to the extent desired by the Magistrat, but Bonn will demand closer supervision over city expenditures than the west Germans have previously exercised.

With the establishment of the Federal Republic, the demand by the Magistrat and the SPD that Berlin be formally included as the twelfth *Land* is likely to intensify. The conservative Government of the Republic may be expected to resist or evade this demand, even if the western occupation powers lift their opposition to it, because inclusion of Berlin would involve greater Socialist representation in the *Bundestag*, and because it would be likely to evoke a very unfavorable Soviet reaction.

SECRET

CHAPTER II

ECONOMIC SITUATION

1. Genesis of the Present Economic System.

The prewar economic system of Nazi Germany was the result of the same detailed planning and foresight that made the German military machine such an effective weapon of aggression. Private enterprise in name only, it was subject to a very large measure of central governmental control. The economy was so ordered as to afford maximum support of the military machine. Germany possessed great aptitude for development along scientific, technical, and industrial lines. This, together with the fact that the Allies in 1919 after the defeat and dispersal of the German army left the German productive capacity virtually intact, made it a relatively simple matter for the Germans to regain and even to surpass pre-1914 levels of production and national income. It was thus possible for their military organization to become more menacing to international security than ever before.

Situated in the middle of Europe, with few natural resources, a soil depleted by generations of intensive cultivation, and with limited access to the sea, Germany in the course of time surmounted these handicaps and became a highly industrialized economy, in which foreign trade played an important part. Organizational weaknesses exposed by the first World War, such as the failure to foresee and prepare for a war of attrition based on an economic blockade of the country, were corrected to a large extent during the subsequent years of peace. In 1939 Germany was a highly coordinated, completely integrated state, self-sufficient to the point of being able to launch and sustain another world conflict of far greater magnitude than the first.

The Germans compensated to a remarkable extent for the paucity of their natural resources by development of synthetic substitutes and by building up stockpiles of essential materials. Also through various exchange

controls and by pursuing calculated trade policies, Germany managed to exert pressures on the economic life of many smaller countries, involving them in long-term commitments and increasing their dependence upon the Reich as a market for exports and a major source of imports. Where this was impractical, the Germans were able to exercise important economic controls in rival countries over prices, production, and distribution of various commodities in world markets through the formation of international cartels. The manipulation of world trade and world resources by German industry through cartel arrangements not only strengthened Germany's ability to make war, but weakened the defensive position of its potential rivals by limiting or reducing their supply of certain strategic commodities. French aluminum production, for example, was curtailed by an agreement which resulted in the export of bauxite ore to Germany, which in turn sold finished aluminum to France. This arrangement seriously handicapped the French upon the outbreak of war in 1939.

Long before 1932 much of German industry and trade was organized into various cartels which proved to be most convenient to the Nazis for the task of mobilizing and "rationalizing" industry for war. German business as a whole was grouped in fully representative trade associations, which had developed joint bodies on a national scale. There were five such bodies (*Spitzenverbände*)—for industry, trade, power, banking, and insurance. After 1933 the Nazis kept the traditional form of these associations but made membership compulsory and introduced the "leadership" principle: appointment from above in place of election from below, with the Minister of Economics in supreme control. Although prevented by statute from engaging in price-fixing and other monopolistic practices, which were left to cartels, the association in many

SECRET

instances was identical as to membership with the cartel. Cooperation between the two was directed by law, the object being to "remove the obstructions and difficulties caused by multiplicity of industrial organizations" and to "establish a comprehensive, tight and uniform organization" instead.

Agriculture was also unified and centralized under the Nazi regime by the formation of the Reich Food Estate (*Reichsnährstand*) with powers of internal administration that extended to price-fixing and marketing. The Administrative Department pushed agrarian improvements through the media of Regional and District Peasant Bodies and controlled distribution through Marketing Boards. Farmers were persuaded to introduce or augment crops that would reduce the deficiency in domestic food production. The high costs involved were offset by high prices and special Reich subsidies. The Food Estate had complete authority over every phase of Hitler's battle for agrarian self-sufficiency, including farm resettlement, mechanization of farms, and land reclamation, and it operated the rationing system which had been put into effect several years before the outbreak of the war.

Such absolute control over the national economy enabled the authorities to shift entire plants, as well as large segments of labor and the agricultural population, according to the demands of a specific industry or a specific government policy. Throughout the war the Nazi government maintained the German economy at a remarkably high production level, despite blockade, damage from the air, and difficulties that arose over distribution and supply as Hitler's armies spread over most of Europe.

Central control of the economy by the Reich government terminated abruptly with the defeat of the German military forces. Thereafter, economic controls, policies, and procedures prevailing in the four zones of occupation were uniform only to the extent that agreements were reached in the ACC.

Although in the early months of occupation some measure of uniformity prevailed, generally economic policies pursued in the zones have varied in accordance with differences in the economic philosophies and interests of the

several occupying powers. This has caused a cleavage, widened with the passage of time, in developments in the western zones and the Soviet zone. In the western zones, for example, control of industry tended to revert to private owners under local German authority and free-market determination of prices has been restored for nearly all commodities. In the Soviet zone, socialization of various industries has been effected and Soviet-owned or controlled firms have been created, while prices are still generally controlled by German authorities in the zone as directed by Soviet Military Government authorities.

Uniform economic policies in the US-UK zones were assured with the economic merger of the two in January 1947. The gradual merger of the French Zone with the "Bizonal" area beginning in October 1948 tended to make western Germany an economic unit. The merger was not completed until the western German Government was established in September 1949.

2. Description of the Present Economic Situation.

a. Agriculture.

One of the most critical hindrances to Germany's postwar recovery was the insufficiency of food to supply the needs of the population, despite heavy relief imports. The German agricultural economy, even after Hitler initiated his agrarian "production battle" in 1934, has been unable to increase to any appreciable extent the area under cultivation, 60 percent of the total area already being improved farmland. Although Nazi land reform, farm resettlement, and land reclamation projects provided a larger percentage of small farms than formerly, there was not a significant increase in cultivated land because of the large areas taken over for airfields and other military installations. Poor soil forced more extensive use of natural and artificial fertilizers, but during the war years a shortage of fertilizers reduced the productivity of German farmlands.

Improved farming methods and governmental subsidies, plus rigorous control of the distribution, consumption, and stockpiling of food and fodder supplies, enabled Germany to

achieve wartime self-sufficiency by 1938 in wheat, vegetables, and dairy products other than butter. Bread and potatoes formed the basis of the normal diet, and 65 percent was supplied by the eastern area. However, the total indigenous food supply to all of Germany was only 85 percent of total consumption. Vegetable oils and feed for livestock remained the weak points in the wartime agricultural economy. Only 48 percent of required table fats (butter, lard, margarine) and 7.5 percent of necessary technical fats for industrial purposes could be produced from sources within the nation. Western Germany as now constituted, cannot supply more than 50-60 percent of its food requirements.

The hectarage, estimated production, and imports of principal crops in the Bizone are as follows:

farm products once again came to be released for distribution through regular channels.

The French Zone, smallest of the four, has felt the food shortage more keenly than the rest, despite heavy imports. The official daily ration in 1947 averaged only about 1,200 calories for the normal consumer, but usually less than this amount was available. A good 1948 harvest improved the food situation, although French requisitions continued to limit amounts consumed by the population. Total daily food consumption by the non-farm population in the French Zone is now estimated to be around 2,300 calories.

Because of the influx of expellees, refugees, and repatriates, the Bizone is now very densely populated, the population having increased 25 percent since 1939. At the same time, food production for the area in 1948

	HECTARAGE		PRODUCTION (Metric Tons)		IMPORTS	
	1938/39	1948/49	1938	1948/49	1947	1948
Bread Grains	2,414,000	2,138,000	5,584,000	4,518,000	4,334,300	6,326,000
Total Grains	4,376,000	3,651,000	10,260,000	7,419,000		
Potatoes	951,000	1,019,000	17,492,000	19,055,000	26,800	347,500
Sugar Beets	148,000	146,000	4,770,000	4,348,000	53,700 (sugar)	634,900 (sugar)
Fodder Pulses	77,000	93,000	157,000	134,000	58,800	102,900

In the postwar period in all zones, almost all farms suffered from lack of fertilizers, seeds, tools, fuel, and spare parts for mechanical equipment. Despite these production difficulties the relative advantages enjoyed by the farming population with respect to available food supplies increased the ill-will of urban workers toward the authorities responsible for the rationing system and toward refugees whose presence was an added strain on the food supply. Farmers also tended to withhold delivery of their assigned food quotas, and thrived on black market trading. Urban workers, unable to satisfy their demands through legal channels, went directly to the farmers to trade their services or possessions for food. This situation greatly improved after the currency reform in June 1948, when

was 10-15 percent less than prewar. Cattle numbers in the bizonal area in December 1948 were 2 percent larger than the year before, but 15 percent below the 1936-38 average. Efforts to reduce fodder crops in order to produce more food for direct human consumption were successfully resisted by German farmers, and increased fodder crop hectarage in 1949 improved the livestock situation considerably, with a consequent improvement in the meat, fat, and milk ration.

During 1936-38 average food production in the bizonal area provided approximately 1,450 calories daily per person for the non-farm population. Average non-farm consumption in these years was about 2,900 calories per person daily in the bizonal area. In the first half of 1949 the average non-farm consumption in the Bizone was around 2,450 calories,

SECRET

which was about 600 calories more than the official ration of 1,850 calories for the normal consumer. Estimates of the 1949 harvest for western Germany, including the French Zone, indicate that the breadgrain crop is substantially above that of 1948 because of a 20 percent larger yield per hectare. The total breadgrain production was 5.88 million tons, and with imports of 2.5 million tons assures the food supply of the Federal Republic and western Berlin. The potato crop, however, was reduced about 20 percent by drought, which also affected other root crops such as sugar beets and fodder beets.

Under the European Recovery Program, western German economic plans call for full land reform, the adoption of various scientific measures, increased production of fertilizers, and imports of food and other agricultural supplies. The German diet has been recently supplemented by an increased use of fish. The small fishing fleet is being repaired and rebuilt to authorized capacity as rapidly as

shortages of materials and fishing equipment will allow.

The Soviet Zone has the largest land area and is the most important zone agriculturally. The zone possesses 35 percent of the total arable land which accounted for 40 percent of prewar breadgrain and potato crops, and half the number of sheep in Germany as now defined. Much of the land reform which the Moscow Conference directed should be finished in 1947 was accomplished in the 1945 initial denazification procedure. The power of the large estate owners was eradicated by expropriation with compensation of all farms over 100 hectares (247 acres), and more than 2 million hectares of land were distributed between the time of occupation and March 1947. Ruthless implementation of this policy created new problems, however, and only 25 percent of the crop land was producing at normal capacity in the spring of 1947 while the rest was producing far below normal or not at all.

GRAIN AREA, YIELDS, AND PRODUCTION SOVIET ZONE OF GERMANY FOR PREWAR, 1948 and 1949¹

Crop	Area (1000 hectares)			Yield (centners per hectare)			Production (1000 metric tons)		
	Prewar Average	1948	1949	Prewar Average	1948	1949	Prewar Average	1948	1949
Wheat	633	474	500	24.6	19.8	20.0	1,554	939	1,000
Rye	1,214	1,290	1,280	17.1	14.2	14.0	2,078	1,830	1,792
Barley	460	250	300	22.4	16.5	16.0	1,029	412	480
Oats	741	562	600	21.5	14.2	14.0	1,590	795	840
TOTAL	3,048	2,476	2,680				6,251	3,976	4,112

¹ Estimated.

LIVESTOCK NUMBERS IN THE SOVIET ZONE OF GERMANY AS OF 3 DECEMBER for 1938, 1945, 1946, 1947 and 1948 (In 1000 head)

ITEM	1938	1945	1946 ¹	1947	1948
Horses	810	590	620	650	665
Cattle	3,644	2,401	2,500	2,783	2,879
Hogs	5,689	1,179	1,900	2,074	2,617
Sheep and Goats	2,438	1,272	1,600	1,758	2,121
Poultry	21,251	5,947	8,000	13,451	15,764

¹ Estimated.

SECRET

Poor harvests in 1947 resulted in severe food shortages throughout the Soviet Zone in the spring of 1948. The shortages were met in part by imports from the USSR and the satellite states. Because of increased hectarage and fertilizer allocations, as well as better weather, the 1948 crop was 25 percent larger than the 1947 crop, and resulted in a considerable improvement in the food situation, even though the USSR continued to requisition scarce items for the Red Army and for export. Although it is difficult to determine quantitatively the average food consumption in the Soviet Zone, recent estimates indicate that the non-farm population in 1948-49 was consuming around 2,300 calories daily. The meat and fat situation has failed to show material improvement; and fish, sugar, and ersatz products continue to be substituted on the meat and fat ration. Peasants' mutual aid associations are now organized along collective lines, and further land reform in this direction is reported in prospect.

Prewar Germany utilized tremendous quantities of commercial fertilizers, and as a result produced very high yields per unit of area on relatively poor soils. Intensive cultivation during the war to obtain maximum food supplies further depleted the soil and increased Germany's dependence on artificial fertilizers.

Before the war Germany was the principal nitrogen producing country of the world. Of its production, which exceeded 700,000 tons for the crop year 1938-39, 70 percent was utilized by agriculture, 16 percent by industry, and the remainder exported. Output was reduced about 50 percent by war damage and other causes, and efforts on the part of the US and UK to provide fertilizer imports in order to restore food production to the highest possible level were circumscribed by the worldwide need for fertilizers, particularly nitrogen. By the end of 1948 nitrogen fertilizer production was back to normal and production almost doubled in 1949.

The bulk (61 percent) of the enormous German potash deposits, estimated at 20 billion tons, lie in the Soviet Zone. Thirty-six percent of the German deposits are in the Bizone where requirements in 1946 exceeded production by 40 percent. Because the barriers in

the way of interzonal trade have operated to prevent the western zones from obtaining substantial amounts of potash from the Soviet Zone, bizonal resources have been intensively exploited. Potash production in the UK Zone, where the principal west German mines are located, amounted in 1948 to 2.41 million metric tons of crude potassium salts. This rate of output was increased nearly 50 percent in the first six months of 1949, which was in excess of requirements and left a small surplus for export.

Because of the general economic dislocation, German agriculture was able to obtain less than half its estimated fertilizer requirements in 1946 and crop yields were 20 percent lower than in prewar years. The Bizone could meet only 37 percent of its potash needs, and 34 percent and 12 percent respectively of its nitrogen and phosphate requirements.* The situation failed to improve in 1947 when bad weather was also a factor in retarding crop production. It was impossible to come within 35 percent of achieving the 1,550 calorie ration level for the normal consumer from indigenous food production, and this necessitated the import of 4.4 million tons of food at a cost of approximately \$600 million. In eastern Germany potash requirements were exceeded by 7 percent, but in the other categories the Soviet Zone was worse off than the western zones, obtaining only 22 percent of estimated nitrogen needs and 5 percent of required phosphates. The situation for all Germany improved considerably in 1948 because of larger fertilizer allocations and better weather conditions. Although eastern Germany can still produce food surpluses, the prospect for western Germany's becoming self-sustaining remains poor in view of the increased population and limited farming area.

Prewar production of potash in the Soviet Zone was over a million tons annually. In 1946, the SMA quota for the zone was 800,000 tons, with production at least 20 percent under this figure because of war damage, power shortages, transportation difficulties, and So-

* In the first six months of 1949, the supply increased to 122 percent of potash needs and 89 and 95 percent respectively of nitrogen and phosphate requirements.

SECRET

II-5

SECRET

viet mine dismantling. Actual production in 1948 was 917,000 tons, of which 60 percent was applied to agriculture and industry in the Soviet Zone and the rest taken for reparations or export.

b. Natural Resources.

(1) *Coal.*

Germany's most important raw material is coal. In prewar Europe, the UK alone surpassed Germany's production and export of hard coal (Steinkohle), two thirds of which came from the industrial Ruhr at the rate of about 10 million tons a month. All kinds of hard coal, containing from 5 to 40 percent volatile matter, are produced, i.e., anthracite, semi-bituminous, bituminous coals of coking and non-coking type, gas and long-flame coals. Over two-thirds of the coal mined in the Ruhr is suitable for coking. The coke ovens not only supply the iron and steel industry but are the source of a whole series of by-products important to the chemical and other industries. Brown coal, of which Germany possesses vast resources, has a high moisture content, and in fuel value nine tons of brown coal is considered the equivalent of two tons of hard coal. It is suitable chiefly for power generation and briquette manufacture.

Three-fourths of the important hard coal reserves, estimated in 1944 at 288 billion metric tons, are concentrated in the Ruhr, where the coal is found in several seams, one above the other, at depths of 1,300 to 2,600 feet, thus enabling many coal beds to be worked from a single shaft. Most of the remainder is found in Upper and Lower Silesia, the Saar, and near Aachen and in Lower Saxony. Of the total reserves of brown coal and lignite, approximately one-third is located along the lower Rhine near Cologne in the British Zone. Important deposits are found in the Soviet Zone, in the vicinity of Leipzig and east of Berlin on the Oder River. France has integrated the Saar mining region into the French economic system. The Silesian area—containing about 25 percent of the reserves of brown coal and lignite—is, with the consent of the western Allies, under Polish administration until a German peace treaty is signed. Because of the Soviet-Polish attitude toward the Oder-

Neisse boundary, quadripartite agreement on the return of Silesia is unlikely. As a result of the war, Germany will have lost one-fourth of its brown coal reserves but not more than 15 percent of its hard coal.

The recovery program for Germany has depended upon the availability of coal and steel, hence Allied efforts have been concentrated on overcoming the formidable handicaps encountered in the mines such as reduced capacity from war damage, inadequate or unskilled labor, and changes in management resulting from decartelization* and denazification procedures. Hard-coal production in the Bizone in 1946 was 55 percent of the amount dug in 1936; in 1947 it was 65 percent, and in 1948, 79 percent of the prewar figure. Brown coal output, on the other hand, has surpassed prewar levels, with the Soviet Zone producing the major share. Ruhr output has fluctuated with the individual miner as he has been affected by such considerations as the food supply, lack of clothing, consumers' goods and housing, the temporary abandonment of the trend toward socialization of the mines, and the political activities of trade union and works councils under the influence of Communist propaganda.

Whereas in 1935, German output of coal per man per day averaged 1.57 tons (as against 4.52 for the US), the present 1949 output in the Ruhr is about 1 ton per man. Until recently output per man was very much lower. To overcome this situation steps were taken by quadripartite agreement to increase miner's pay by 20 percent, to improve living conditions by granting special housing and repair priorities and to place greater managerial responsibility on German shoulders. Recruiting and incentive programs, featuring extra food-ration allotments, also produced favorable results. But the postwar daily production remained far below the hard-coal tar-

* In 1913 independent coal mines controlled over 50 percent of the coal resources, but by 1940 only 10 percent remained in independent hands. During the war this small percentage was further reduced by incorporation of some of the remaining independent mines into the Ruhr steel combines. France and the Benelux countries also have a financial stake in German coal mines.

SECRET

COAL PRODUCTION IN THE RUHR DISTRICT

	1936	1946	1947	1948	INCREASE IN 1948 OUTPUT OVER 1947		1948 PER- CENTAGE OF 1936
	<i>(in million metric tons)</i>				<i>(tons)</i>	<i>(%)</i>	
Coal	116.96	53.95	71.12	87.0	15.9	22.4	74.4
Coke	27.79	9.04	13.24	19.0	5.7	43.2	68.2
Coal briquette	4.41	1.90	2.18	3.0	0.8	36.2	67.3
Lignite	52.92	48.17	54.73	60.7	6.0	10.9	114.7
Lignite briquette	11.30	10.5	11.59	12.6	1.0	8.8	111.6
Workers Employed	284,100	320,200	390,800	409,200	18,400	5.8	44.0

get of 350,000 tons daily until September 1948, when the release of hoarded goods brought about by the currency conversion, the effects of the better food situation, and the larger number of coal miners employed, began to be felt. Average daily production reached 335,000 tons in the first half of 1949, and increased allocations to German industry brought about a marked improvement in the general economic situation. Of the coal mined, German industry receives about 50 percent, of which the iron and steel industry receives about one-fourth. The railways receive about 10 percent, domestic consumers about 6 percent, and the occupation forces about 4 percent. Another 10 percent is consumed by the collieries, and the rest, approximately 20 percent, is exported. France receives about 35 percent of these exports.

(2) Timber.

Slightly over a quarter (27.5 percent) of prewar Germany was covered by forest, which yielded timber as well as material for paper, wood-fiber cellulose, and other products. Despite a highly advanced system of reforestation, Germany's prewar wood supply was insufficient for its needs.

Germany emerged from the war with its forests relatively undamaged. About 40 percent of the forest area is in the US Zone, 30 percent in the Soviet Zone, and the rest divided equally between the French and UK Zones. An acute timber famine exists in all Zones despite greatly increased felling. Loss of East Prussia and the territory east of the Oder reduced the forest area of Germany by 25 percent. Present Germany has a forest area of 23.6 million acres, of which 19.5 million acres

are commercial forests. The commercial forests are estimated to be growing annually 6.8 billion board feet of timber in trees of more than 2.75 inches in diameter. Norway spruce is the most common tree in the Bizone, and spruce forests cover 40 percent of the forest area. Scotch pine covers 26 percent and beach forests 21 percent of the area. Spruce and pine furnish the ordinary construction timbers and most of the common lumber used in Germany. The total cut in 1947-49 was 7.5 billion board feet, which was greater than normal growth, and indicated a serious depletion of forest resources. At this rate of cutting, it is estimated that sawlog-size trees will be gone in eight years. Consequently, the occupation authorities have ordered a progressive decrease in the cut and are also reducing timber exports in an effort to preserve the productive capacity of the remaining German forests.

(3) Petroleum.

Germany has small petroleum resources. Eight fields in the Hanover region produced about 550,000 tons in 1938, no more than eight percent of prewar requirements. Their chief importance, however, lay in their yield of valuable light oils from which lubricants are derived. Present consumption of lubricants in the bizonal area is approximately covered by domestic production. A sudden or general increase of industrial activity, however, may cause a bottleneck in lubricants. Refineries in the UK Zone, where the only important oil fields are located, supply present restricted civilian needs in all three western zones. These plants are to be rehabilitated and modernized for refining Venezuelan and Arabian crudes.

S E C R E T

In 1948 the refineries processed 738,904 tons of petroleum, of which 276,000 tons were imported from Venezuela and the Near East. Domestic oil production in 1948 was 626,810 tons from 28 oil fields. Bizonal consumption of POL products in 1949 is estimated at 2.7 million tons, which will require a continuation of the strict licensing control of petroleum supplies.

The manufacture of synthetic gasoline, amounting to 2 million tons in 1938, was prohibited by the occupying powers in 1945 because of its war potential as well as its expense, one ton of liquid fuel requiring 15 to 20 tons of brown coal. Two of the six west German Fischer-Tropsch plants were maintained in operation, however, in order to reduce the cost of petroleum imports. In the spring of 1949 all facilities were ordered removed in conformity with the agreement on Prohibited and Restricted Industries. Producing nearly at capacity, Soviet Zone synthetic plants (such as the Leunawerke near Merseburg) for extracting gasoline and diesel oil from lignite and coal supplied about 14 percent of Germany's liquid fuel needs during the early war years. War damage and dismantling reduced this capacity from 2.27 million tons to approximately 1.1 million tons in 1948. The USSR has acquired the plants for the Soviet economy and is reported to have produced about 450,000 tons of gasoline and 200,000 tons of diesel fuel in 1948. Production and distribution of the estimated civilian requirements of gasoline, oil, and lubricants for 1949 will call for utilization of all undamaged and salvageable equipment in the western zones, and may require all refinery equipment in western Germany, so that no surplus has been scheduled for reparations.

(4) *Iron.*

The insufficiency of domestic iron ore was one of the most serious of all raw-material problems hampering the economic progress of Nazi Germany. The principal German iron ore deposits are in the Siegerland, Lahn-Dill, Salzgitter, and Bavarian districts. Reserves of first-grade ore were estimated in 1938 at 350 million tons and of second-grade ore at 300 million tons. Most of these deposits are

small, widely scattered, and frequently remote from coal fields.

German ore is lean, averaging less than 45 percent iron after treatment as compared to Swedish ore which ranges from 58 to 72 percent iron content or Spanish, 48 to 58 percent. Furthermore, German ore, unlike the low-grade minette ores of Lorraine, is not self-fluxing and requires expensive treatment for removal of silica and other impurities. Nevertheless, physical lack of plants to treat domestic low-grade ores was a national weakness in 1939, since Germany was dependent upon imports of foreign ores for two-thirds of its annual prewar consumption of 33 million tons. Sweden furnished almost 50 percent of these imports and France 25 percent. The phosphate derived from Swedish ores is an important source of fertilizer. In contrast to short supplies of iron, Germany had abundant coal resources, production of coking coal in prewar years being sufficient not only to meet all domestic requirements but also to provide an exportable surplus which helped pay for iron ore imports. German iron ore production in 1948 was 6.5 million tons or nearly double that of 1947 and 12 percent greater than the 1936 output. Germany was also deficient in ferro-alloys and alloy materials, such as nickel, molybdenum, chrome, and tungsten, all essential to the manufacture of high-grade alloy steel. Chrome was obtained mainly from Turkey, tungsten from the Iberian Peninsula, and nickel and molybdenum from Scandinavia.

(5) *Aluminum.*

Although German deposits were negligible, providing less than 25,000 tons of ore annually compared to imports of over 1 million tons, Germany, before the war, ranked first among the nations of the world in the capacity of its aluminum industry. Most of the bauxite ore obtained during the war came from Hungary and southeastern Europe, and, after 1940, large quantities were imported from France. During the war, annual aluminum consumption rose to a peak of around 470,000 tons of metal, with German plants producing about 65 percent of this amount. Many aluminum plants were destroyed in the

course of the Allied invasion; others were dismantled and removed as reparations. Although production of primary aluminum (virgin ingots from bauxite) was originally banned by Allied agreement and imports were limited to 30,000 tons of metal a year, or about one-tenth the annual consumption rate for 1939-44, production of aluminum up to 85,000 tons annually is allowed under the PRI agreement. Aluminum production in 1948 from both primary and secondary sources was 42,000 tons in the Bizone. The French Zone has one aluminum plant with an annual capacity of 35,000 tons. Requirements for the Soviet Zone, which is dependent mainly on Hungary for bauxite, were stated at 60,000 tons in 1948, of which about 60 percent was estimated as available.

(6) *Zinc and Lead.*

A decade ago Germany was next to the United States and Belgium in the world smelter production of zinc and was able to supply about two-thirds of its annual consumption of 225,000 tons from indigenous ore. It shared with Yugoslavia first place among European producers of lead, although consumption was about three times the annual output of German mines. The chief sources of lead and zinc are in Upper Silesia, the Harz Mountains, and along the Rhine River, about 165,000 tons of zinc and 80,000 tons of lead being obtained annually from these deposits. Because zinc predominates two to one in the ore, Germany during the war relied heavily upon lead concentrates imported from Yugoslavia. Bizonal smelter production of zinc and lead in 1948 was only 40 percent of what it had been in 1936. Soviet Zone production in 1948 was approximately the following: recast zinc—1,298 tons; lead concentrates—741.1 tons; lead and lead alloys—11,922 tons.* (Germany's large Silesian zinc mines have been given to Poland by the USSR.)

(7) *Copper.*

Shortage of copper contributed materially to Germany's military defeat. During the war the use of copper was confined to the

* 1946 Soviet Zone zinc production was 14,000 tons and lead 6,566 tons.

manufacture of aircraft and to other essential military purposes, while aluminum was substituted for it in all commercial and domestic uses. The amount of copper mined in Germany has remained stable during the last 30 years, and production could not be essentially advanced either in the prewar years or during the war. The estimated annual mine output of finished copper was 25,000 tons, and the total refinery capacity about 300,000 tons. The copper industry was an important element in the national economy, and Germany was able to compete successfully in world markets in semi-manufactured and finished copper products, of which about 100,000 tons a year were exported. The proceeds in foreign exchange gained in this manner were sufficient not only to cover the import of copper ores, concentrates, and scrap (totalling about 260,000 tons annually) but to leave a substantial surplus for the import of other goods from abroad.

The German copper industry passed largely under Soviet control. More than 50 percent of the copper products plants and nearly all the large smelters and refineries are located in the Soviet Zone, where 90 percent of the copper is mined, most of it in the Mansfeld district of Saxony-Anhalt. Production in 1948 was 24,000 tons of copper, mainly from 1.3 percent ore. Because Mansfeld ores are sub-marginal, mining in the past was economically possible only with state subsidies, which have been continued by the Soviets and charged to the *Land* Government of Saxony-Anhalt. With the price of copper fixed at RM 735 per ton in 1948, production costs were RM 8,000 per ton, and the yearly subsidy was estimated at RM 52 million, the deficit being made up by *Land* subsidies.* The USSR has refused to permit an increase in the price of copper and is reported to have shipped large quantities to the Soviet Union, which have been credited to German reparations at the low price supported by subsidies. Ore production in 1946 was 371,000 tons, or about 40 percent of what it had been before the war. The USSR is striving to reach the prewar level and

* The world price of copper was RM 1,300 per ton in 1948.

has embarked upon an extensive program of mine renovation and enlargement; the output per miner, however, is still below the prewar average. Copper production in western Germany in 1949 is expected to reach 120,000 tons, of which two thirds is electrolytic and the rest fire-refined.

(8) *Tin.*

Since the Middle Ages tin has been mined in Germany from small low-grade deposits in the Erzgebirge, peacetime production averaging about 150 tons per year, 1,000 tons during the war. The average annual consumption in prewar years, however, was about 14,000 tons. The deficiency was partly filled by ore imported from Portugal, Spain, Bolivia, and the Netherlands East Indies and reduced in German smelters; in addition, some tin metal imports were required.

Germany was among the largest continental consumers and smelters of tin, with an annual smelter output of approximately 5,000 tons. In March 1946 the Allied Control Council set the permissible level of the German tin industry at one half the 1938 rate and allowed an annual maximum consumption of 8,000 tons.

(9) *Vanadium.*

An essential component of high-speed steel tools and other high-tensile, heat-resistant steel products, vanadium was the one alloying element found in Germany in quantities nearly sufficient for war needs. When nickel and chromium became very scarce early in the war, vanadium was widely substituted in their place. Three sources were available: vanadium-bearing slags from Norway, minette (low-grade) iron ores, and recovery from the Bayer aluminum process. By far the most important was the minette ore of Luxembourg and Belgium, which, before the war, enabled Germany to meet its annual requirements of about 15,000 tons. Vanadium production from iron-ore slags has been forbidden in Germany since the war under the Level of Industry Agreement.

(10) *Magnesium.*

Until 1942 Germany was the world's leading producer of magnesium accounting in

1940 for nearly 60 percent of the world supply of 36,500 tons. Magnesium output increased enormously during the war, and was used extensively in airplanes, incendiaries, rocket launchers, flares, and tracers.

Following the surrender, primary magnesium production was banned by the Allies for an indefinite period, but is being produced in the Soviet Zone at the rate of 500 tons per month.

(11) *Graphite.*

All the economically important graphite mines are located in southeast Bavaria, with small deposits in Silesia and Thuringia which yield an inferior grade of ore. The Bavarian deposits have been mined for centuries, but modern mining did not begin until the first World War. Small holdings were then consolidated into a few strong companies which, in 1938, were merged into the Graphitwerke Kropfmuehl A.G., the dominating group in the industry until the collapse in 1945. Annual production of all grades was approximately 30,000 metric tons of raw graphite; finished graphite about 8 to 10,000 metric tons.

The high melting point of graphite and its resistance to burning in air make graphite industrially useful as a refractory agent in crucibles and foundry facings.

(12) *Beryllium.*

Germany pioneered in the production of alloys from this rare metallic element, particularly in connection with beryllium-copper alloys and later on as a replacement for molybdenum and tungsten in the production of steel. Since 1935 a single plant at Frankfurt-am-Main has been the only producer of beryllium metal and oxide in Germany, the total output during the war amounting to 18.8 metric tons of oxide and 4.1 metric tons of metal. Ore supply originally came from Brazil; after 1940 Scandinavian, Portuguese and Italian stocks were obtained. An Italian firm near Turin was under German control until the expulsion of the Nazi armies, and the entire output was shipped to Germany. German progress in atomic bomb development was halted by the surrender, and as part of the industrial disarmament program for Germany, the pro-

duction of materials of primary importance in atomic research, such as beryllium, has been prohibited.

(13) *Uranium.*

Since September 1945 the USSR has been exploiting the uranium deposits of the Erzgebirge area on both sides of the Czechoslovakian border of Saxony. These workings are said to be shallow, consisting of crude, timber-lined shafts, from the base of which workers tunnel to follow the vein of ore. Necessary electrical energy is furnished by high tension installations removed to this area from other parts of the Soviet Zone. Some 100,000 Germans have been drafted from the Soviet Zone and forced to work in the mines under heavy guard. Soviet mining methods are primitive; working conditions are bad, and accidents are frequent. Old ore dumps are also being worked over for uranium, and the Soviet authorities are carrying away such zinc and cobalt ores as have been salvaged. The entire area is sealed off by Soviet military forces, and no one is allowed to enter or leave without special authorization from the administrative headquarters of the district at Aue. The cost of these mining operations is borne by the *Land* Government of Saxony.

According to Soviet reports, Erzgebirge uranium ore is of very high quality, believed to be the best in the world, and very easy to mine. German technical opinion has it, on the contrary, that the very fact that the USSR is mining pitchblende from such a poor source is an indication of a lack of better sources on which to concentrate. The yield of uranium ore from Saxony pitchblende deposits never amounted to more than 10 tons annually, the mines having been worked chiefly for cobalt and bismuth ores employed in the Saxony blue-dye industry. Total uranium reserves in the Erzgebirge area (German and Czech) are estimated to be about 600 tons U_3O_8 (uranium oxide). The USSR is believed to be exploiting this source at the rate of about 50 to 80 tons per year.

(14) *Pyrites.*

Sulphuric acid, the most important inorganic chemical used in industry, is prepared mainly from pyrites, of which Germany has

limited deposits in Westphalia and Bavaria. Before the war these furnished less than 40 percent of the annual domestic requirement of one million tons, the rest being imported chiefly from Norway and Spain. Sulphuric acid was produced in 66 plants located in three major areas; Westphalia, Bavaria, and Saxony. Much of the plant capacity was war damaged or dismantled, particularly in the Soviet Zone, where a shortage of sulphuric acid has been one of the principal limiting factors in the zonal economy. Bizonal production of pyrites in 1948 was 383,000 tons, while sulphuric acid production was 821,000 tons, or about 80 percent of what it was in 1936. The Soviet Zone produced 68,000 tons of pyrites in 1948 and imported 133,700 tons. Sulphuric acid production was 151,000 tons or about 50 percent of requirements.

(15) *Potash.*

Enormous reserves of potash, estimated at 20 billion tons, enabled Germany before the war to supply 65 percent of the world's total potash salts. Potash is prepared in various forms, the chloride and sulphate being used principally in the manufacture of fertilizers, the sulphate in the manufacture of glass, the carbonate in the manufacture of soap and glass, the chlorate in the manufacture of matches and explosives, the nitrate in the preparation of gunpowder, glass, enamels, and fertilizers, the cyanide in metallurgy, and caustic potash which is used in soapmaking, textile processes, and manufacture of potash chemicals. Mine owners at an early date combined to regulate production and maintain prices through a cartel known as the *Deutsches Kalisyndikat*, which confined operations to 30 or 40 of the lower cost mines on a quota basis and closed down the remaining 200 shafts, which were maintained, however, in a standby condition. Germany dominated world trade, except for the period of the first World War, through international cartel agreements to partition markets and stabilize prices. Loss of foreign markets in the second World War was offset by more intensive use of potash for domestic agricultural and industrial purposes. Wartime sales for the six-year 1939-44 period averaged 1.7 million tons K_2O

SECRET

annually, of which 70 percent went to agriculture, 3.5 percent to industry, and 18.5 percent for export, with a small amount left undistributed. Potash production in 1948 in the Bizone was 510,000 tons (K₂O content) and in the Soviet Zone 917,000 tons, of which 180,000 tons were taken for reparations and 238,000 tons for export.

(16) *Salt.*

The basic raw material of the important alkali chemicals is common salt, of which Germany ranked first for many years among world producers and exporters. The average prewar output was 3 million tons, of which 800,000 tons worth RM 10 million were exported. About 82 percent of the salt was disposed of through two syndicates, the larger of which was an association of big potash companies that also mined salt. The principal salt works in the US Zone total 10, in the UK Zone 28, in the Soviet Zone 23, and in the French Zone 6. Salt mining was resumed in the bizonal area in 1946 and quickly brought to prewar production levels.

Despite the abundance of alkali raw materials, the chemical industry operated at such a low level until 1948 that the production of caustic soda and soda ash was insufficient to meet demands. Consequently there was a serious shortage of soap, detergents, and other cleansing agents, while industries such as textiles, glass, paper, and rubber were also seriously affected. The largest caustic soda plant in Germany was at Bitterfeld, now in the Soviet Zone, which produced 32 percent of the prewar total. Dismantling and inadequate fuel supplies affected the capacity of this plant, and only 110,000 tons were manufactured in 1948. Output of caustic soda in western Germany reached 155,000 tons in 1948, an increase of 80 percent over the preceding year. Production of soda ash in 1936 was 726,000 tons, with the largest plant at Bernberg, now in the Soviet Zone, with an annual capacity of 410,000 tons. In 1948 Soviet Zone production was only 82,000 tons. Soda ash production in western Germany was 377,200 tons, or slightly in excess of the 1936 output for that area.

c. Industry.

The chaotic condition into which Germany was plunged by total defeat and the collapse of its industrial system is in sharp contrast to the stability, efficiency, and high degree of organization characteristic of German economy in the past. The disaster was the more spectacular because of the complexity of the preponderantly industrial economy which was geared to war production, but readjustment was not made less difficult by the disappearance of a sizable section (war goods) of an industrial complex that provided a livelihood for millions of Germans. Efforts of the western Allies to get Germany back on a production level approximating that of 1936 were handicapped by the fact that the entire economic structure was so badly warped and disturbed by the stresses of the intervening twelve years as to prevent its functioning on any but a low level, and then only with considerable outside assistance. The situation was further aggravated by the lack of structural economic unity resulting from the division of Germany into the four separate political and economic administrations, with a fortuitous distribution of resources and without an effective coordinating authority. Regional specialization and economic interdependency, carried to great lengths by the Nazis in order to maximize production, also accentuated the troubles arising from the separation of the country into sharply delineated zones of occupation. Moreover, the failure to effect currency reform during the period 1945 to June 1948, led to universal hoarding of goods, and thus the potential ability of Germany (all zones) to contribute to its own recovery was not realized.

Other important factors contributing to the continuance of the economic slump were the reparations, demilitarization, decartelization, and denazification programs of the Occupation Powers which: (1) closed and dismantled plants; (2) prohibited the production of war-potential materials formerly important to domestic industry and to the export market; (3) partially decentralized and destroyed long-established operational methods of whole industries; and (4) removed managerial talent

from the once closely integrated industrial machine.

Before the currency conversion in June 1948, the bizonal production level was only one-half of the estimated 1936 level. Between June 1948 and July 1949 the combination of currency conversion and Allied (chiefly US) aid brought production up 60 percent in Bizonia or to about 88 percent of Bizonia's estimated 1936 level.

The French Zone has a different economic structure and lacks industrial concentration. Agriculture is the principal occupation, the total value of agricultural products being about twice the total value of industrial products (\$50 million to \$28 million in June 1949). Agricultural yields in 1949 were only 70 percent of prewar, and great efforts have been required to improve the poor postwar food situation, in consequence of which the average consumer ration has been increased from 1,700 calories to 2,000 calories in the past year. Because of substantial imports of raw materials under the ECA program, there has been a marked increase in industrial activity. The official index of industrial production (1936=100) in the third quarter of 1949 was 85, compared to 81 in the second quarter, or a 70 percent increase over the corresponding period in 1948. Nevertheless, there is serious unemployment, arising mainly from lack of raw materials in several basic industries, and the financial picture is marred by the prospect of continuing budgetary deficits. Budgets are expected to be brought into better balance, however, by the release of counterpart funds for investment purposes. The 1949/50 investment program calls for an expenditure of DM 716 million, 41 percent of which is from counterpart funds and 20 percent from public subsidies.

The Soviet Zone possessed an industrial capacity at the end of the war sufficient for most requirements, but Soviet dismantling and reparations policies soon reduced it to a point below the minimum needs of the population. Later, the USSR reversed its policy of stripping the Soviet Zone of industrial capacity and built up basic industries in order to meet quotas established under the Two-Year Plan. Most of the production was sent to the USSR. The

Two-Year Plan, adopted in June 1948 set targets for 1949 and 1950 by which over-all production was to increase at the end of the period to 81 percent of that of 1936. This represented an increase of 20 percent over the 1948 level and 35 percent over 1945. Soviet Zone total production in 1947 was approximately RM 10 billion (based on 1944 prices); the 1948 level was to be increased 10 percent over this, but shortages and other bottlenecks prevented targets from being reached in all major fields except coal. Costs of production remain high, although productivity of labor has been increased by the introduction of the Hennecke and other labor speed-up or worker incentive systems. Because Soviet methods of computing values are open to question, and official quotas are frequently changed, fulfillment of the Two-Year Plan is problematical, although Soviet Zone production has improved in many respects since the lifting of the counterblockade in May 1949 and the restoration of western German sources of supply for critical items.

Outstanding individual industries are treated separately in the remainder of the section.

(1) *Electric Power.*

Prewar Germany was the most powerful industrial nation in Europe, ranking first in world production of brown coal, second in steel and electric power, and third in the output of hard coal. German industry was 85 percent dependent on electric power, and German power stations had a higher installed capacity and a higher output than those of any other European country. In normal times Germany produced annually about 24 billion kilowatt hours, but the Nazi rearmament program increased this to 40 billion kwh in 1936 and to 68 billion in 1943, which was the wartime peak production. A network of transmission lines, 18,000 miles in length, connected the generating plants in a vast grid, normally assuring supply of power to all industrial areas. Because of the enormous war potential of this industry, Germany's electrical generating capacity was drastically reduced under the Level of Industry Agreement. About 40 percent of electrical capacity was in industrial plants, many of which were in the war-potential class

and were scheduled for removal together with such generating plants as were considered surplus to revised industrial needs.

In 1948 electric power output was 18 billion kwh. Brown coal plants generate 41 percent of Germany's power output, hard coal plants 35 percent, and water power 14 percent, while gas, wood, and oil provide the rest. Practically all of Germany's hydro plants are located in the US Zone, which has little coal and must depend on coal imports from the Ruhr to operate its thermal stations. During the low hydro winter season, or in periods of prolonged drought, these thermal stations supply much of the zone's electrical power.

Of a total capacity of 10 million kilowatts of plant installed in what is now the bizonal area, only about 17 percent was available for service at the surrender. War damage, inadequate maintenance, shortage of fuel and essential replacements, and dispersal of personnel were the principal causes of the almost total breakdown of the once great German electric power system. Some of these difficulties have now been overcome, but shortages of fuel, transport, and materials still constitute serious handicaps to complete restoration of normal services for both industry and private consumers. Allocation of materials, like steel, cement, bricks, earthen conduits, and insulators were only 15 percent of requirements, while deliveries of coal generally did not exceed 60 percent of minimum needs. Nevertheless, by July 1947 nearly 46 percent of the plant capacity was back in operation. The rate of improvement has since become very slow owing to lack of repair materials.

The electrical supply situation is satisfactory for present needs. Replacement of worn or obsolete equipment and construction of additional power plants are delayed, however, by the lack of available capital. Consequently, generating capacity increased less than 10 percent in 1948 and 1949. In order to assure an equitable distribution of available supplies of current, rationing of electric power for domestic and commercial purposes is maintained, and a priority list was established for power supply. Executive control of the industry was transferred to the Germans on 1 January 1947, but responsibility for the determination of the

level of industry, reparations, and exports was retained by MG. Estimated power requirements over the next four years for a self-sustaining German economy are 16 million kilowatts of plant, or almost twice the amount of power now available. Although the electric power industry has high priority for investment purposes, the stringency of bank credit has interfered with plans for expanding plant capacity and building new power plants. As of June 1949, DM 110 million has been made available from GARIOA counterpart funds for a number of special power projects, but further grants are contingent upon German ability to provide funds from their own resources for this as well as for other investment needs.

Electric power output in the Soviet Zone increased 7.7 percent to 7.9 billion kwh in the first six months of 1949 over the last six months of 1948. This fell short of the planned quota for power production largely because of the embargo on spare parts and machinery from western Germany. With the restoration of normal sources of supply, power output is expected to improve somewhat. Power breakdowns are frequent, however, and the supply remains inadequate to industrial needs without further extension of plants and facilities, for which available funds are also short.

(2) *Electrical Equipment.*

Up to 1945, production, research, and development of German electrical equipment were in the hands of two large corporations—the Allgemeine Elektrizitäts Gesellschaft (AEG) and Siemens und Halske—which turned out equipment for generating, transmitting, distributing, and utilizing electrical energy principally for power, heating, and lighting, and manufactured radio and telephone equipment as well as aviation instruments, radar, and other electronic devices. While German progress in the field of electronics during the war did not match that of the Allies, German electronic scientists made substantial contributions to Nazi military power. Many of these developments would still constitute a menace to international peace and security in irresponsible or unfriendly hands. Production of German elec-

SECRET

trical equipment was therefore limited by quadripartite agreement to 30-50 percent of prewar capacity; while scientific research was restricted to the exploration of new principles, and their application to military purposes was prohibited.

Since the electrical equipment industry was concentrated for the most part in Berlin,* it suffered heavy war damage and then fell into the hands of the USSR at the time of the occupation. The largest electronics plant, which was located in the UK sector of Berlin, was completely dismantled by the Soviet officials during their occupation of the city before the establishment of quadripartite control. Soviet economic penetration of this field has been greater than in any other, and Soviet AG's now control 80 percent of the industry. The USSR is steadily increasing the production of plants manufacturing electronics equipment and has been building up the huge Siemens works at Arnstadt in Thuringia, where a large number of German scientists and technicians have been assembled for research on electronic devices, particularly radio equipment for guided missiles and television, transmitters for remote control of aircraft. Estimated production of electrical equipment for industrial uses in the Soviet Zone is 67 percent of what it was before the war, while in the bizonal area (1948) it is 120 percent and in the French Zone 61 percent.

(3) *Iron and Steel.*

In prewar Germany the two great coal fields of the Ruhr and Saar in the west and Silesia in the east represented by far the principal German iron and steel producing areas. The Ruhr district, situated at the focal point of an excellent water transportation system, easily accessible to the great minette ore fields of Lorraine, and overlying enormous high-grade coal deposits, has for years been one of the greatest steel producing regions of the world. In 1936 the Ruhr accounted for 70 percent, the Saar for 12 percent, and all other

* The total value of all electrical equipment produced in 1936 was RM 1.5 billion, of which about one-half was produced in Berlin and one-third in the bizonal area.

areas including Silesia* for 18 percent of the total German steel output. This regional concentration was matched by the formation of a cartel of eight companies, controlling 95 percent of Ruhr steel production. During the war, the steel capacity available to Germany was doubled by the absorption of plants and mines in occupied countries.

German rearmament involved a tremendous program of economic self-sufficiency, particularly in steel. Since the German steel industry was concentrated close to the frontiers and thus vulnerable to air attack, the Reich in 1937 began mining domestic low-grade ores for new steel plants erected in the center of Germany. The Hermann Goering Works, a government corporation, was formed to mine ore and build and operate steel works and coke ovens. Salzgitter ores (± 30 percent Fe, high phosphorous) because of the difficulty in removing impurities, were uneconomical, but the Nazi self-sufficiency plan called for a production of 21 million tons, of which 15 million were to be treated in the Hermann Goering Works. This total was never attained, since the acquisition of the Lorraine ore fields in 1940 relieved Germany of the strained iron ore situation and gave a sufficient supply to meet all war purposes—60 million tons of 30 percent iron content from which 18 million tons of pig iron were made. The Germans then lost interest in the Salzgitter works, which at present consist of eight blast furnaces with an annual capacity of a million tons of pig, and six Bessemer converters with an annual capacity of nearly a million tons of steel.

At the close of the war, the Lorraine fields reverted to France, which also acquired the Saar, while Poland took Silesia. There was thus left to Germany the vast steel productive capacity in the Ruhr which had, however, limited ore resources of poor quality. The iron and steel industry had, moreover, come to a complete standstill. Considerable war damage had been sustained; the highly complicated industrial structure was badly disor-

* Silesia, together with northern, eastern, and central Germany—11.2 percent: Siegerland and Hesse Nassau—2.2 percent: Saxony—3.1 percent: Southern Germany and Bavarian Palatinate—1.9 percent. Total—18.6 percent.

SECRET

II-15

SECRET

ganized, and transportation facilities in the coal fields were totally disrupted. It was several months before production could be resumed. Meanwhile, agreement had been reached at Potsdam on the destruction of Germany's war potential, and steel was the yardstick against which German peacetime industrial productivity was to be measured. A substantial amount was essential for a reasonable recovery program, and under the March 1949 Prohibited and Restricted Industries Agreement, steel production in the bizonal area was set at 11.1 million tons.

Continued shortages of coal and electric power were serious handicaps to increased bizonal steel production, which in 1947 totalled only 2,460,000 tons and 5,750,000 tons in 1948. Transportation bottlenecks interfered with the movement of coal and ore to the plants and with the distribution of the semi-finished product. Labor was also a problem because of the absence of skilled workers, the general inefficiency resulting from the lack of food, and the large percentage of workers of advanced age. Substantial imports of Swedish iron ore and increased coal allocations, however, raised the output of bizonal German steel in the first half of 1949 to approximately 4.2 million tons; but further improvement is limited by the difficulties mentioned above. In line with US-UK policy, management of the industry in the Bizone is now very largely in German hands, but many steel works have been dismantled or allocated for dismantling on reparations account to the dismay of the Germans who oppose further progress in this direction because of the crippling effect at a time when extraordinary efforts are necessary to revive the entire German economy.

The French Zone is receiving imports of steel on reparations account from the bizonal area, and the French expect by 1951 to be producing about three times as much steel in their zone as the present 100,000-ton output which will still be hardly sufficient for local needs. Since German industries in the French Zone are geared for export to France, steel products have been given a low priority in contrast to other materials needed more urgently by the French economy. Security considerations have also influenced the French toward

keeping postwar German steel production at the lowest possible level, and they were reluctant to approve any advance in the Potsdam total of 5.8 million tons for Germany as a whole. It has been estimated that, on the basis of a population of 70 million, Germany will require 14 million tons of steel annually to meet the minimum needs of its economy, a figure which the French feel is at least 40 percent too high.

The most important deficit of Soviet Zone industry has been iron and steel, and it has held down replacements or renewals in all industrial fields. Before the war the Soviet Zone produced 2 million tons of steel annually; present production is 250,000 tons a year, and the minimum requirements are 1,200,000 tons. Soviet removals of steel-producing facilities have cut capacity to 27,000 tons a month. Imports from the western zones were inadequate, and these were absorbed to a great extent by the Soviet AG's, leaving the socialized industries of the *Laender* to operate on far less than the minimum requisite stocks. Following the blockade of Berlin, steel deliveries from the Ruhr ceased altogether, except for a certain amount of clandestine traffic, and the Soviet Zone had to depend upon imports from the USSR and the Satellites and work began on reconstruction of dismantling plants. Although Silesia, an important steel-producing area, has passed under the control of Poland, the USSR has had difficulty in obtaining steel from that source because Soviet Zone goods offered in exchange were unsatisfactory. The USSR wants a larger share of the iron and steel products of the Ruhr, and this need has been responsible for much Soviet propaganda in behalf of German political and economic unification. It has also inspired Soviet demands that German steel production be utilized entirely for the rehabilitation of Germany.

(4) *Machinery Industry.*

Under this heading are included all industrial machinery, electrical machinery and apparatus, prime movers, machine tools, construction and mining machinery, automotive equipment, locomotives, and ships. In pre-war years Germany's contribution to the

world's supply of machinery was of great importance, in general paralleling that of Great Britain. Excluding Great Britain, Germany's production was greater than that of all the rest of Europe. The machinery industry, probably more than any other branch of German industry, made possible the supply of military matériel for Germany. During the war years production of machinery more than doubled in quantity while industry as a whole increased only about a third. Total production of machinery during the year 1938 was about 5 million metric tons. Production in the various zones was about as follows: Berlin, 14 percent; US and UK Zones, 47 percent; French Zone, 18 percent; and Soviet Zone and areas under Soviet control, 21 percent.

Machinery production capacity in Germany at the close of the war was far in excess of that of peacetime requirements and therefore many plants were scheduled for dismantling while production was limited by quadripartite agreement. Production of various categories of machinery, which has been increasing slowly since the cessation of hostilities, is currently about 40 percent of 1936.

During prewar years German exports of machinery varied between one-fourth and one-seventh of the quantity produced, and Germany supplied about 25 to 30 percent of world imports. Imports into Germany were comparatively very small. Categories of which large tonnages were exported included metal-working machine tools, textile and agricultural machinery, internal combustion engines, locomotives, steam turbines, electrical machinery, and apparatus. Germany supplied about 70 percent of European requirements of machine tools of which about 25 percent went to the USSR. Germany produced about 20 percent of the world supply of electrical goods, and German exports exceeded those of either the United States or the United Kingdom. In many other categories of machinery Germany was also the principal supplier to the European markets.

(5) *Rubber.*

Prewar Germany had the largest rubber industry in continental Europe, importing 100,000 tons of natural rubber in 1937, out of

which was manufactured a wide range of articles from hose and belting to rubber shoes and automobile tires. It not only sufficed for domestic needs but allowed for an export of about 6,000 tons. The chief center of the rubber industry was Hanover, now in the UK Zone, which is manufacturing tires at about 75 percent of prewar levels and exporting a small amount of processed rubber. Since no synthetic rubber is produced in the US Zone, tires have been imported from the US to keep motor vehicles operating at about one-third the prewar volume of traffic.

As late as 1937 the only German production of synthetic rubber was in an experimental plant at Leverkusen. Under the four-year plan of that year, however, construction of three large plants was commenced at Schkopau (near Leipzig), Hüls, and Ludwigshafen. Later a fourth plant at Auschwitz, Poland, was built but only partly operated before the end of the war. After further expansion, the plant at Schkopau, with an annual capacity of 72,000 metric tons, was the largest in Germany. The ultimate planned capacity of the four plants was 192,000 tons per year, or about twice Germany's prewar consumption of natural rubber. This large capacity was necessitated by cessation of imports and exhaustion of stocks of crude rubber. The bulk of the synthetic rubber output went to the Wehrmacht for tires.

Although the Potsdam Agreement provided for the elimination of all industrial facilities for the manufacture of synthetic rubber, the critical shortage of this material resulted in the temporary retention of three buna plants, which produced 45,000 tons of synthetic rubber in 1946. The Schkopau plant, now in the Soviet Zone, was operating in 1947 at a rate of about 42,000 tons per year, but partial dismantling reduced the capacity to 17,000 tons in 1948 and 27,000 tons (planned) for 1949. The only other German plant in operation was the one at Hüls in the British Zone, with a capacity of 10,000 tons per year. The latter ceased production in early 1948. The French closed the huge I. G. Farben buna factory at Ludwigshafen and made it available for reparations because the coal necessary to produce one ton of buna will produce

SECRET

five tons of nitrogenous fertilizers having five times the value. Except for a few elementary processes, manufacture of synthetic rubber was placed on the prohibited list in the 31 March 1949 agreement.

(6) *Chemicals.*

Germany possesses large natural reserves of most of the basic raw materials needed to produce the multitude of chemical products essential to a modern industrial economy. Coal, limestone, salt, potash, and wood are abundant within the country, but most of the sulphur and pyrites has to be imported.

Before the war Germany was the largest producer and second largest exporter of chemical nitrogen. The prewar output of about 700,000 tons per year was nearly one-third of the total world production, and of that quantity nearly 100,000 tons were exported. Present policy is to limit German production of nitrogen to its own needs, but because of coal shortages, war damage, and dismantled plants, the country is actually on an import basis.

Three-fourths of Germany's prewar nitrogen was produced by the Haber process in the form of synthetic ammonia. Since this is basic to the manufacture of high explosives, the restoration of German nitrogen manufacturing facilities has been retarded by Allied concern for the high war potential of the industry. Moreover, quadripartite policy with regard to Germany has been to limit its nitrogen production to its own consumption, thus further delaying reconstruction, since 80 percent of the nitrogen was produced in ten plants, all of which sustained severe war damage.

Eastern Germany has comparatively few fertilizer plants. Assuming full operation of these, annual nitrogen production in the Soviet Zone would be about 100,000 tons. Production capacity for phosphate fertilizers is 30,000 tons P_2O_5 (phosphoric acid) yearly, but actual production in 1946 was only 9,000 tons. Most Soviet Zone phosphate factories are not working because of the lack of raw phosphates. Imports are possible under barter trade agreements; even so, it would not suffice to meet the annual requirements of

50,000 tons P_2O_5 . Furthermore, the Soviets have taken considerable amounts of nitrogen and phosphate as reparations, leaving most of the fertilizer needs of their zone to be met from indigenous potash deposits.

Germany was the largest producer and exporter of dyes before the war. Prewar (1936) production of dyes and organic chemicals amounted to RM 499 million. The volume of exports averaged about 33,000 tons per year and ranged in value from RM 200 million to RM 336 million. The present limitation of RM 58 million on exports of dyes is not being attained owing to dislocations of the formerly highly integrated industry, shortages of raw materials, and lack of overseas sales organizations and credits.

The former large production and exports of pharmaceuticals, plastics, and synthetic organic chemicals has also almost disappeared because the erection of zonal barriers interrupted production processes in this formerly highly integrated industry, and, in addition, because of limitations on production imposed by the occupation authorities, 40 percent in the case of chemical raw materials, 80 percent in dyes and pharmaceuticals, and 70 percent in other chemical products. Export targets in chemicals are unlikely to be reached before 1949.

Possessing only small resources in petroleum, Germany built up a huge calcium carbide industry to provide acetylene as an alternate material for its synthetic rubber and plastics industries, and for certain other synthetic organic chemicals, all of which would be based on petroleum were it available in sufficient quantity, as well as to provide acetylene for its metal working industries. Of world production amounting to over 1,800,000 tons of calcium carbide in 1939, Germany produced about 1,000,000 tons. Dismantling of plants and shortages of coal and electricity had reduced the output in 1946 to 30,000 tons in the Soviet Zone and 304,000 tons in western Germany. By 1949 annual production had recovered in the Soviet Zone to 381,000 tons and in the Bizone to 385,000 tons.

Before the war, soda ash, caustic soda, sulphuric acid, and chlorine were also manufactured in quantities sufficient not only for do-

mestic needs but for a substantial export trade. Chemicals accounted for 7 percent of the total value of all products manufactured in Germany in 1936, or RM 2.2 billion, of which nearly 30 percent was exported. The industry was dominated by I. G. Farben, the largest chemical firm in the world, which produced 100 percent of Germany's wartime requirements of synthetic rubber, 98 percent of its dyestuffs, 75 percent of its chemical nitrogen, 61 percent of its calcium carbide, 55 percent of its pharmaceuticals, and 46 percent of its chlorine, as well as a great variety of other chemical products such as plastics and X-ray film. This vast concern ceased to exist after the surrender, and a large number of its plants were immediately dismantled or allocated for reparations. Although revival of the dyestuff industry has been marked since currency reform, production of dyestuffs in 1949 was only 25 percent of that in 1936. Production in 1949-50 is expected to rise from 11,500 tons to 25,000 tons, with exports increasing to 7,000 tons, of which about half will be shipped to the Soviet Zone.

In the chemical field, coal is the most important raw material, and the small allocation of coal to the German chemical industry was the main reason for its low production rate until late in 1948. There also have been difficulties in obtaining imported raw materials such as sulfur and pyrites, borax, iodine, camphor, vegetable drugs, and medicinal herbs. Furthermore, the various I. G. Farben plants,* although located in different parts of Germany, were nevertheless highly integrated, and consequently the necessary interchange of semi-finished products and intermediates between the Soviet Zone and the western zones, and vice versa, now so difficult, further complicated matters. Dismantling of plants, as well as decartelization and denazification procedures connected with the dissolution of I. G. Farben, have also retarded recovery in the chemical industry, which was

* Distribution of I. G. Farben properties is as follows: Soviet Zone 58.5 percent, Bizonia 21.5 percent, French Zone 20 percent. In the US Zone 77 of the 199 I. G. Farben installations have already been liquidated; in the Soviet Zone 86 out of 201, although all important plants are now Soviet-owned.

one of the most complex in Germany. Recovery in the US Zone, where 20 percent of the plants are located, was retarded by a total dependence upon the other zones for raw materials such as coal, pyrites, and synthetic ammonia. It was not until well into 1946 that the industry could be reactivated to any great extent. Fuel and power shortages were especially acute, the severe winter of 1946-47 causing a temporary shutdown of the entire chemical industry. In 1947 Bizone production was only 45 percent of the 1936 level, but with more coal and power available in 1948 it increased to 70 percent and in the first quarter of 1949 to 78 percent.

The greatest concentration of chemical plants occurs in the UK Zone, which has 35 percent of the total, but production in 1947 was only 40 percent of prewar levels. Chemical plants in the Soviet Zone, which has 28 percent of the total, suffered severely from war damage and then from sporadic Soviet dismantlings, so that chemical output has lagged considerably behind postwar objectives. The Soviet Zone industry has been further handicapped by the loss of raw materials attributable to the counterblockade of Berlin. Thousands of German chemists and technicians have also been taken to Russia to work on scientific projects and on erection and operation of plants for the USSR. The chemical industry in the French Zone, with 11 percent of the plants, has shown irregular production trends.

(7) *Textiles.*

Before the war (1937) Germany's consumption of all kinds of fibers was estimated at 969,000 tons, of which new and reclaimed domestic fibers accounted for 29 percent, imported raw cotton for 35 percent, and imports of wool, jute, flax, and hemp for the rest. Although the textile industry for the most part was not extensively damaged, recovery has been much slower than in other industrial fields because of the excessive dependence upon the import of raw materials such as cotton and wool, and the difficulty of obtaining chemicals for the manufacture of artificial fibers of the rayon type. The Level of Industry Plan allowed for the processing of 665,000

SECRET

tons of raw material (185,000 tons of artificial fiber and 480,000 tons of natural fiber), but production in 1948 had not reached one-half of this figure, except in synthetic fibers, which is now 50 percent above prewar levels. In order to revive the cotton spinning industry in the US Zone and to furnish employment for thousands of idle workers, the US Government has imported large quantities of raw cotton under the disease and unrest program.* Of the 152,000 bales of US cotton shipped to Germany in 1946, more than one-half was utilized for the processing of textiles for re-export to provide foreign exchange for payment of the cotton. The British have also imported raw wool and Egyptian and East Indian cotton into their zone under a similar program, and hemp has been obtained from Italy for the manufacture of rope and binder twine.

The German textile industry was centered in what is now the Soviet Zone. Because most of the spinning and weaving mills are located in the Soviet Zone, the west German textile industry is faced with a difficult equipment problem and is dependent upon imported machinery to effect an appreciable improvement over present production levels. While Soviet Zone machinery is sufficient to supply the needs of the population, lack of raw materials has forced the industry to run considerably below normal capacity. Soviet Zone raw cotton imports from the USSR dropped from 22,000 tons in 1947 to 7,000 tons in 1948, and only a slight increase in textile output was possible, mostly in artificial fibers. Actual production in 1949 is not expected to exceed 4 kilograms of material per head. Artificial fiber production in the Soviet Zone in 1948 was 40,000 tons, and the Two Year Plan calls for 90,000 tons by 1950, to achieve which will necessitate the building of several cellulose factories.

Under ECA it is planned to raise the consumption of textile raw materials in western Germany. In 1948 it amounted to 271,000 tons, or about 6.5 kg per head, and in 1949 it is expected to reach 409,000 tons, or 9.7 kg per head. Cost of these imports will rise from \$86 million to \$140 million. Artificial fiber

* See page II-30-31 on International Trade.

production in 1948 was approximately 100,000 tons. At present, the Bizone has 3.9 million running spindles, the French Zone 0.7 million, and the Soviet Zone about 2 million. In all zones obsolescence of equipment is a great handicap to further progress in the textile industry.

(8) *Other Industries.*

It would be hard to find an industry in Germany today which is not handicapped by shortages of material. Wood-working has been unable to procure the right type of lumber, glue, metal findings, or finishing materials. Furniture supplied for German civilian use was generally unfinished because of the shortage of shellac. Although Germany was a large manufacturer of leather goods, it imported a large part of the hides and skins prepared in tanneries. Leather output in 1948 was only 49 percent of prewar production, but the import of 63,000 tons of hides under the ECA program, in addition to the 20,000 tons from the domestic slaughter of cattle, permitted the manufacture of 2.7 million pairs of shoes monthly, which is still far short of reasonable requirements. The scarcity of pulpwood has handicapped the paper industry and restricted the publication of books, magazines, newspapers, and writing material. Ceramics has always been an important German industry, and an abundance of fine clays is available, but production until recently has been limited by the relatively large amount of coal required per unit of finished ware. The optical industry has been decentralized, and recovery has been retarded by the difficulties in the way of interzonal trade. Cameras are manufactured in the US Zone, but optical glass, lenses, and shutters must be obtained from the French and Soviet Zones. There is a ready international market for German optical products, and a percentage of cameras is set aside to pay for Germany's large import bill.

The need for building material was acute because of war damage. A system of licensing and control was instituted in order to assure an equitable distribution of such materials and to prevent their utilization for non-essential purposes. Cement production was limited

SECRET

to 8 million tons annually, but the rate of production was insufficient to reach this level. Glass and lumber were difficult to obtain and the production of bricks was not more than 10 percent of prewar capacity. Consequently, the production of building materials did not reach one-third of the prewar output. Following currency reform, however, employment increased in all the building material producing industries, and in the building industry itself. In October 1948, brick production was five times the average production in 1947, and cement production was 93 percent of the average production in 1936. Increased building costs and lack of investment capital have

hampered the reconstruction program, and housing conditions remain bad. Except for makeshift repairs, progress is retarded by the factors limiting German economic recovery in general.

d. Financial.

(1) *Banking.*

During the period when Germany was preparing for and prosecuting the last war, the German private banking system through purchase of government obligations supplied the bulk of credit needs of government agencies and financed construction in the war industries. The large German banks financed the

INDEX OF INDUSTRIAL PRODUCTION BY MAJOR INDUSTRY GROUPS
BIZONAL AREA
 1936 = 100

Period	All Industry Groups	Coal	Building Materials	Chemicals	Paper and Pulp	Leather	Textiles	Sawmills	Electricity and Gas	Iron and Steel	Mining (excluding Coal)
1947											
1st Half	39	61	42	44	30	37	29	94	86	24	71
1947											
2nd Half	43	72	41	51	33	31	32	83	99	29	86
1948											
1st Qtr.	48	77	45	59	37	42	44	66	103	32	99
1948											
2nd Qtr.	51	74	59	54	41	36	41	53	110	30	93
1948											
3rd Qtr.	66	82	N.A.	66	60	56	59	60	115	44	111
1948											
4th Qtr.	76	86	N.A.	75	67	65	67	72	135	55	114
1949											
1st Qtr.	83	90	N.A.	83	81	71	81	81	142	60	121
1949											
2nd Qtr.	85	88	N.A.	85	84	73	88	82	131	60	124

German cartels, syndicates, and trusts, and they also exercised, through interlocking directorates, considerable influence over the greater part of the German monopolistic groupings such as I. G. Farbenindustrie, Siemens & Halske, Krupp, Rhein-Metall-Borsig, and others. The Third Reich in turn exercised extremely wide powers in supervision of banking, concerning itself especially with the dismissal and appointment of the higher banking officials.

In its broad outlines this institutional control system had been established well before the advent of the Third Reich, but the degree of control over industry and the concentration of this control in the large Berlin banks (Grossbanken) were accentuated during the 1929-1939 period. Among some 650 commercial banks in Germany, the six Grossbanken (Deutsche Bank, Dresdner Bank, Commerz Bank, Berliner Handelgesellschaft, Reichskreditgesellschaft, and Bank der Deutschen Arbeit) accounted for 55 percent of total assets and 59 percent of total deposits in 1938. The Reichsbank, with a network of over 500 branches, served as the main bank of note-issue and as the fiscal agent for the Reich.

At the beginning of the occupation existing economic controls and financial machinery in Germany was preserved and utilized, as far as was consistent with occupation policies. This included the maintenance by local authorities of such anti-inflationary measures and other economic controls as had been established by German law, and, in the western zones, the continued functioning of most of the banks. Branch banks were permitted to retain a reporting and policy relationship with main offices in their own *Laender*, but this relationship was not allowed to cross *Land* or zonal boundaries. The Reichsbank discontinued its former function of issuing bank notes and assumed the functions of a commercial bank. In addition, Military Government in the western zones employed the Reichsbank as its fiscal agent, as a supervisor of certain bank activities in each zone, and as a medium for transmitting and administering certain Military Government financial laws.

At Potsdam in 1945 the Occupying Powers agreed to eliminate excessive concentration of

power in the banking systems and to establish a uniform policy with regard to currency and banking. Implementation of the agreement on currency and banking, however, was delayed by lack of agreement on other essential matters. The Western Powers, therefore, followed an interim policy of liquidating the central boards of German banking monopolies and decentralizing them to the *Land* level. The USSR regarded these steps as partial measures and regarded the desire of the US, UK, and France to couple the elimination of excessive concentration of economic power in banking with the creation of central banking machinery as an attempt to delay a decision on German monopolies, in order to preserve them. Inability to reach agreement on such fundamental issues hampered the orderly extension of credit, contributed to inflation, and retarded economic recovery.

In the British Zone of Occupation the banking system was, with few exceptions, permitted to remain substantially unchanged pending quadripartite agreement on the future system to be adopted for the whole of Germany. Decentralization of banking without some form of centralized control was not, in the British view, a satisfactory solution of the problem and was not in accordance with accepted principles of economic unity. The USSR, on the other hand, closed all German banks in existence at the time of the capitulation, seized all assets, and stopped payment on old obligations of the German credit system. The USSR then established provincial, city, and regional banks of *Laender* and *Provinzen* Governments, employing new personnel and thereby solving the problem of denazification. In order to restore the economy, the newly established banks granted long-term credits for the revival of industry and the needs of agriculture. All stock exchange transactions are forbidden Soviet Zone banks, which are also not allowed to deal in securities issued before the capitulation of Germany.

In the French Zone of Occupation, German banks were authorized to continue functioning with the exception of the branches of the Bank der Deutschen Arbeit which had close affiliations with the Nazi Party. Branches of banks whose main offices were situated out-

side the French Zone had to sever their connections with the main offices. The Reichsbank established two offices, one in the North and one in the South, to supervise the Reichsbank's branches; and a supervisory board for the French Zone was set up at Speyer. Subsequently the French authorities cooperated with the German authorities in the implementation of measures which should result in a situation similar to that which exists in the US Zone: i.e., the liquidation of the Reichsbank, the creation of three *Laender* Central Banks, and the liquidation of the former branch bank system, which will be replaced by banks with branches exclusively in the *Land* in which their main office is located.

In November 1945 US Military Government proposed to German *Land* finance officials the establishment of a basic *Land* central banking organization which could be coordinated on a zonal basis and later integrated with any subsequent banking plan for Germany as a whole. The Germans were reluctant to cooperate in such a decentralization scheme, and little action was taken on the US proposals. Finally, in December 1946, legislation acceptable to US Military Government was enacted and became effective in all three *Laender* on 1 January 1947. When Bremen was established as the fourth *Land* in the US Zone on 21 January 1947, the Reichsbank district lines were adjusted to follow the political boundaries, and the new system was extended to include Bremen.

This law created a State Central Bank in each *Land* of the US Zone to take the place of former Reichsbank branches, and to function as bankers' banks similar to the US Federal Reserve Banks. In the absence of a uniform quadripartite agreement on currency and debt problems for Germany as a whole, the State Central Banks could not be granted the right of issue. For the same reason it was not possible to liquidate the Reichsbank entirely. The new State Central Banks were assigned the Reichsbank's current assets as well as the greater part of its liabilities. The Military Government appointed a Trustee in each *Land* to administer the Reichsbank's remaining assets and liabilities, the latter consisting mainly of accounts which had been blocked

for political reasons by the Military Government. To facilitate an eventual liquidation of the Reichsbank on a zonal basis, a General Trustee for the Reichsbank was also appointed for the entire US Zone.

The great commercial banks also resisted Military Government efforts to decentralize their economic power. Therefore, Military Government Law No. 57 was promulgated on 6 May 1947. It provided for the appointment by each *Land* government of an independent and disinterested custodian for the Deutsche Bank, Dresdner Bank, and Commerz Bank, to manage and administer the property of these banks within the respective states. The names of the banks were changed, and the influence of present officials and shareholders on the management was eliminated. Administrative regulations cut off the "giro system" (a system for the inter-bank transfer of funds) of the banks beyond state boundaries and forced all clearings of more than RM 100,000 to be carried out through the *Land* Central Bank system. Contrary to the fears of German officials, the law did not weaken public confidence in the banking system. There was no run on the banks, no increase in withdrawals, and no attempt to transfer funds to other zones.

The financial reforms imposed by the occupying powers on the western zones in June 1948 completely altered certain aspects of the banking situation in those areas.

The cancellation of the Reich debt and the conversion of other debts in June 1948 by the western Allies reduced deposit liabilities by 90 percent but wiped out entirely 80 to 90 percent of the assets of the commercial and savings banks. The structure of bank assets was then rebuilt. The State Central Banks credited the banks with amounts equal to 15 percent of their total (converted) deposit and savings accounts. The banks also were allotted "*Ausgleichsforderungen*" (claims against the State bearing 3 percent interest) to the extent that remaining assets proved insufficient to cover their liabilities including "appropriate capital" to be determined by the Bank Control Authority.

The banking system in the western zones was unified in June 1948 by the creation of

the Bank of German States, which acts as a depository of State Central Banks' required reserves. After the repudiation of Reich obligations, State Central Banks were credited with an amount equal to 30 percent of their (converted) deposit liabilities and their holdings of small notes and coins.

Banks in all three western zones were brought under reserve requirements similar to those already prevailing in the US Zone. Against current accounts State Central Banks are required to keep reserves of 12 to 30 percent with the Bank of German States, while for other banks (including Post Cheque Offices and Postal Savings Banks) reserve requirements are 8 to 20 percent. Reserve requirements against deposits and savings were established at 4 to 10 percent.

Until the June reforms, the banking structure in Berlin under occupation resembled that of the Soviet Zone in that all pre-occupation institutions (excepting the Volksbank, an urban credit cooperative) were closed and all pre-occupation bank accounts blocked. Only four banking institutions operated in the Soviet Sector, two of them municipally owned. These two, the Berliner Stadt Kontor and the Sparkasse der Stadt Berlin, were created after the Soviet occupation of the city and before quadripartite government was established. Only the Stadt Kontor was authorized to make loans at the beginning of the occupation, and these were limited to short-term credits. More recently this bank has been authorized to extend both municipal and private long-term credits, but it is not permitted to make loans to other banks. All interzonal cashless transfers in the Soviet Zone and Berlin are cleared through the Stadt Kontor, but only transfers in payment for goods may be made with the Soviet Zone and Berlin. Of the two other financial institutions, the Post-scheckamt provides only postal giro or clearing services, while the Volksbank, which was authorized to reopen in December 1945, supplies the normal services of an urban cooperative system.

In the Soviet sector following currency reform the Deutsche Emissions- und Giro-bank was converted on 20 July 1948 into the Deutsche Notenbank (German Currency

Bank), which was given the right to issue currency and to perform commercial banking functions. All bank deposits, which had been blocked up to 60 percent after currency reforms were transferred to the Notenbank to provide it with loans funds and to insure centralized control over all commercial banking in the Zone. The chief customers of the Notenbank are the Soviet Zone central administrative organizations, the Soviet corporations (AG's), and the Soviet commercial companies. An additional function of the Notenbank is the financing of reparations from current production and other exclusively Soviet interests in eastern Germany. Other firms must obtain operating funds either from their Soviet enterprises or from cooperatives. The Investment Bank under the Control of the DWK remains the main agency for granting long-term credit, and as such exercises a powerful influence in shaping the economic development of the zone in conformity with Communist purposes. The Garantie und Kreditbank is the dominant institution controlling foreign trade and foreign exchange transactions in the Soviet Zone.

(2) *Currency.*

The printing and issue of Reichsmark currency which ceased during the last weeks of the war was not resumed. At the end of the war there were about 60 billion Reichsmarks and about 10 billion (some estimates run as high as 20 billion) Occupation Marks, compared to RM 10.5 billion in 1938, in circulation in Germany. Most of the Occupation Marks represented an excess issued by the USSR early in 1945 under an agreement among the Occupying Powers to use a single form of occupation currency, the Allied Military Mark. This large supply of money, coupled with a low level of production of goods, resulted in an increasing tendency among the German population to refuse the Reichsmark in business transactions and the payment of debt and to demand other forms of compensation. By 1946 the Reichsmark would purchase rationed goods, but little else.

Since currency reform was basic to the solution of Germany's economic ills, the occupying powers sought agreement on concerted

measures for all four zones. The Allied Control Council agreed on the issuance of a single currency, for the whole of Germany, to be known as the Deutsche Mark. Adoption of the plan on a quadripartite basis was blocked, however, by the failure of the US and Soviet delegates in ACC to agree on a site for printing the new currency. Whereas the US insisted on having it printed in Berlin under close quadripartite supervision, the USSR wanted part of the total amount printed at Leipzig, an arrangement which the US believed would result in further unregulated issuances of currency detrimental not only to the German economy but to the US financial position in Germany.

The apparent unwillingness of Soviet authorities to cooperate in reviving the German economy and the pressing necessity of such a revival in the western zones to the success of the Marshall Plan finally impelled the western Allies to break the currency reform impasse. The western Military Government authorities, therefore, proceeded jointly in the three western zones* with a currency conversion and related financial reforms by three laws promulgated within one week, that ending 26 June 1948.

The first law introduced a new Deutsche Mark and provided for the conversion of the old coins and currency—Reichsmarks, Rentenmarks, and Allied Military Government notes—into "*Deutsche Marks*" at the rate of 10 RM to 1 DM. The second law established the Bank of the German States as the Bank of Issue and introduced reserve requirements for all banks. The third, or Conversion Law, announced the all-important conversion rate of 10 to 1 for bank accounts, private liabilities of all kinds, insurance policies, and the like. A comprehensive tax reform was also introduced. The thorny question of the disposition of obligations of the old Reich was settled by voiding them. Fiscal and banking features of the reforms are discussed under appropriate headings elsewhere.

* Reforms instituted in the western sectors of Berlin are treated above: see page I-16-17. Discussion of the currency reform in the Soviet Zone is found on page II-26.

Other important features of the currency reform may be summarized as follows. All old currency was turned in. Each inhabitant of the western zones was allowed to exchange 60 RM for 60 DM, and business enterprises were granted a special allowance of 60 DM for each employee in order to provide cash for immediate needs. (Subsequently bank accounts were debited 540 RM, the difference between the 60 RM surrendered and the 600 RM required for exchange of 60 DM.) Reichsmarks surrendered in excess of 60 RM were credited to bank accounts. These accounts (which included both surrendered cash and old credit balances on deposit) were divided equally into two types—"Free" and "Fixed" accounts. Their RM value was converted to DM value at a rate of 10 to 1. The "Free" accounts were made immediately available for withdrawals; the "Fixed" accounts were blocked until October 1948. At that time it was decided (over the protests of German financial authorities) to unblock 20 percent of each of the "Fixed" accounts, to destroy 70 percent, and temporarily to continue blocking the remaining 10 percent.

Salaries and wages were made payable in DM on the old RM scale (and wage increases up to 15 percent were authorized). This stipulation put businesses under pressure to sell hoarded stocks of goods in order to maintain a liquid position. The bank accounts of public authorities were rendered void; public expenditures were to be met out of current receipts. Prices of a wide range of consumer goods were decontrolled, with the exception of most foodstuffs and raw materials. Clothes rationing was also reintroduced.

The imposition of these reforms, was damaging to certain laboring and business groups. The reforms were, however, a necessary prelude to recovery as soon became manifest in the disappearance of black markets, the re-appearance of goods in shops and markets, a decline in unemployment, and a sharp increase in production. It was plain that the western Allies had planned for an eventual level of Deutsche Mark prices much higher than the prewar Reichsmark price level, since the present note issue limit is equivalent to DM 220 per capita against RM 86 per

capita in 1933. The increase would seem to be justified, however, both because world prices have increased considerably in the intervening period and because the German people apparently want to hold a large proportion of their assets in liquid form. Western Allies were concerned, however, by the possibility that the October release of 20 percent of the blocked accounts would set off a wave of price increases, and further the disparity between wages and prices. Should such a development be attended by renewed hoarding and labor disturbance, the consequent decline in production would tend to cancel the economic improvement brought about by the June 1948 reforms.

Soviet authorities were quick to counter the conversion in the western zones with a currency reform applicable to the Soviet Zone, including the Soviet Sector of Berlin. The conversion in the Soviet Zone was remarkable in that although low income groups in the zone received somewhat more favorable treatment by its terms than these groups received in the western zones, publicly owned enterprises and Soviet owned corporations were excluded from conversion requirements. Thus the reduction in the volume of currency was not so drastic as in the western zones.

The first 70 RM turned in by an individual were converted at a 1 to 1 ratio, without being debited to bank accounts. A ratio of 10 to 1 was established for the conversion of the next RM 5,000. For sums in excess of RM 5,000 no conversion was permitted individuals until investigation proved that the sums had been lawfully acquired. Cash holdings of firms, organizations, and institutions were exchanged at 10 to 1. Current accounts were converted at 10 to 1 for the first RM 5,000; amounts in excess of RM 5,000 were subject to proof of legitimacy. A 1 to 1 conversion rate was allowed for funds of public authorities and accounts of publicly-owned enterprises. For funds of the State-owned insurance corporations the conversion rate was 5 to 1, and of the social insurance institutes was 2 to 1. Earnings of war profiteers, profits derived from speculations, and ac-

counts of war and Fascist criminals were confiscated.

Savings deposits received special treatment. The conversion rate was 1 to 1 for deposits up to RM 100; 5 to 1 up to RM 1,000; and 10 to 1 from RM 1,001 to 5,000. Accounts in excess of 5,000 were subject to proof of legitimacy.

Debentures were issued in place of current reserves and savings deposits established before 9 May 1945 at a conversion rate of 10 to 1, provided that balances in excess of RM 3,000 could be proved legitimate.

No change was authorized in wages, salaries, and taxes. The reform did not affect internal and foreign public debts, and the liabilities of closed banks were also unaffected.

The differences in the financial reforms of the western zones and of the Soviet Zone have brought about a difficult financial situation in Berlin, where dual currency and banking systems exist as well as separate budgets for the German municipal governments of the eastern and western sectors. The failure (to date) of negotiators of the Western Powers and the USSR to reach agreement on financial matters in Berlin, however, is symptomatic of the continuing basic disagreement on the control of Germany and Germany's future role in Europe.

(3) *Government Finance.*

In the sphere of financial policy in Germany the Allied Control Authority was faced with the problem of reorganizing the revenues and expenditures of German budgets to insure not only the reconstruction of a peaceful economy but also the fulfillment of reparation claims, occupation costs, and other obligations imposed on Germany under the terms of the surrender.

During the war and the years immediately preceding it, the German budgets were adjusted to satisfy the military program of the Reich. Expenditures for the period of the war were approximately 650 billion Reichsmarks, of which 600 billion were devoted directly or indirectly to war expenses. Of this expenditure not more than one-third was covered by tax and other ordinary forms of revenue. The greater part of the remainder was

financed by an issue of public debt of approximately 400 billion Reichsmarks, equal to 31 times the indebtedness at the beginning of the Nazi regime and five times the prewar national income of Germany. Of this issue only a small part was sold to the public, the bulk being distributed to various credit institutions. The Reich indebtedness was further expanded as a result of war damages and compensation for other war losses until the total Reich debt was around RM 900 billion. At the end of the war there was little prospect of this debt being serviced. During the first three years of occupation all national debt service charges were omitted from government budgets. Upon repudiation of such debts in June 1948 all service charges on Reich debt were eliminated in western zonal governments for the future.

Following the surrender of Germany in May 1945, regular governmental expenditures dropped sharply. As has been stated, payments of interest on the Reich public debt were suspended, and those on the debt of lower governmental units were generally discontinued. Outlays for war production, as well as for maintenance of the Military Services, were terminated; payments on account of war damage claims, pensions, relief grants, and other war expenditures were either eliminated or severely restricted by Military Government. Officials and employees of the former Reich who were not required for essential functions taken over by the *Laender* were removed from the payrolls; and certain functions, such as the political police, were eliminated. On the other hand, large extraordinary governmental expenditures occurred. They included occupation costs, care of displaced persons, and general relief. Total extraordinary expenditures (occupation costs, expenditures for displaced persons, refugees and expellees, prisoners of war, interment camps, port costs in Bremen, contribution to *Land* Central Banks, and the like) have constituted over a third of the total expenditures of *Laender* governments.

In order to provide the funds required for the fiscal operations of the *Laender* governments, a reorganization of the German tax system was necessary. Formerly, the prin-

cipal revenue producing taxes were levied by the Reich but were collected by the States, the Reich returning a share to the States, which in turn passed on a proportion to the Communes. Yearly budgets were approved by *Laender* governments but had to be submitted to the Reich Finance Minister whose final approval was essential in the case of long-term loans, utilization of reserves, and the acquisition, sale or mortgage of estate property of the province. Thus the Reich tax administration was highly decentralized for operating purposes but closely controlled as to policy by central offices. After the capitulation, the former Reich financial mechanism ceased to function, and the Reich budget ceased to exist.

One of the first tasks confronting the occupying forces, therefore, was to devise interim expedients for utilizing the decentralized remnants of the former administrative machinery. At an early date, the tax powers of the former Reich were vested in the individual *Laender*, so that existing tax offices continued to collect Reich taxes under the jurisdiction of separate *Land* Ministries of Finance. These revenues were made available for local as well as *Land* purposes. At the same time all special tax favors granted the Nazis and their followers in existing legislation were removed, and discriminatory taxes against Jews and other racial minorities abolished.

The low level of production, trade, and income of the immediate postwar period resulted in a precipitant drop of 60 percent in *Land* tax collections for the fiscal year 1945 in the US Zone. At the same time, in spite of the sharp reduction in incomes, inflationary pressures created by the years of deficit war-financing remained as a threat to the already shattered economy. To reduce the dangers of inflation, as well as to provide larger government revenues to meet rising costs, the ACC in February, May, and June 1946 revised and drastically increased the rate schedules for most types of taxes.

As a result of these measures, German tax collections in all zones, which averaged RM 10.1 billion annually in the years 1933-1937, amounted to RM 21 billion during the fiscal year 1946-47. Compared to RM 1.8 billion collected in 1945 in the four *Laender* of the US

SECRET

Zone, collection in 1946-47 amounted to RM 4.6 billion, of which 78 percent was income, property and transportation taxes, and 22 percent customs and excises. Tax collections in the combined US-UK Zones for 1946-47 were RM 10.8 billion as against RM 5.7 billion for the previous year, an increase of 90 percent.

Despite heavy expenditures requirements including substantial occupation costs, and in contrast with virtually all neighboring countries, budgets of all western zones were brought approximately into balance by 1947. This feat was accomplished only by omission of all national debt-service charges from the budgets. The repudiation of the Reich debt in June 1948 relieved western zonal governments of all such charges in the future. The chief inflationary pressure prior to currency reform came from the excessive volume of currency and deposits created during the war and not from the current spending of German governments. While tax increases have been heavy, particularly in view of low production, only limited recognition was given in German circles to the fact that German taxes during the war were 30 percent lower than those of most countries, and that only the incidence of these burdens and their allocation among social and economic groups can be altered.

The tax situation of the *Laender* in the western zones was drastically altered by the financial reforms of June 1948. Under the new system, income and wage taxes were reduced about one-half, and the tobacco tax was reduced about one-third. Inheritance and corporation taxes were altered without a probable change in yields, and a capital transaction tax was re-imposed. A heavy coffee tax was also imposed. In addition, the *Laender* were authorized to levy additional taxes, including surcharges on the scheduled taxes. On balance the new system will result in a shift to heavier dependence upon indirect, regressive types of taxes and to less dependence upon income taxes.

Although currency reform accomplished most of its major objectives, one of the chief remaining threats to financial stability is unbalanced public budgets. Deficit public spending has resulted in a net addition to the money supply already sufficiently large to exert con-

siderable inflationary pressure on the economy. Public budgets at all levels are experiencing difficulty in adjusting their expenditures to reduced revenues. The budget of the Bizonal Economic Administration for the fiscal year 1948-49 was balanced at 408 million marks, a 100 million mark increase over the previous fiscal year, but almost 200 million marks lower than the precurrency reform estimates for the current fiscal year. Although the 1949-50 budget is balanced, it is by no means certain that expenditures will be covered. The bizonal budget depends for its revenues mainly on the statutory contributions of the German Post (100 million marks) and the German Railways (174 million marks). The financial condition of these agencies is such that considerable difficulty will be experienced in making these funds available. In addition, the Bizonal Economic Administration is required to provide funds to finance the support of Berlin. The development of the *Laender* budgets since currency reform has shown that deficits of dangerous magnitude must be expected in a number of *Laender* unless drastic measures are applied. Cash balances have dropped by almost one-half, and tax revenues have shrunk rapidly, while payrolls have continued to expand. *Laender* encountering the most troubles are those such as Schleswig Holstein which bear the brunt of heavy occupation costs or of large expenses for refugees and evacuees. No action has been taken on the problem of equalizing such burdens.

By the spring of 1949 the progress of western German recovery showed signs of slowing down. Further improvement appeared to be hampered by lack of capital for long-term investment. The shortage of loan funds forced the banks into a cautious lending policy, interest rates were high, and the principal method of financing the needs of industrial and business enterprises was the unorthodox one of discounting three month trade bills. Despite Military Government pressure to develop a long-term investment program, little was accomplished because of inadequate savings and German disinclination to provide capital from German sources by taxation. To control deflationary tendencies in an economy (which is potentially inflationary) and to remove

SECRET

some of the more dangerous production bottlenecks, Military Government established a credit of one billion west marks for emergency investment purposes, of which DM 220 million were earmarked for the expansion of the electric power plant program in order to reduce the bizonal power shortage. Military Government efforts also resulted in the passage by the Bizonal Economic Council on 20 April 1949 of an acceptable tax reform law retroactive 1 January 1949, devised to encourage both saving and investment. Nevertheless, the Germans continued to rely heavily on the future availability of foreign capital plus ECA counterpart funds and to minimize both the necessity and possibility of developing internal sources of investment funds. The German authorities were advised, however, that Military Government would not permit more than DM 2 billion to be drawn from counterpart funds for capital investment purposes and that the remaining DM 6 billion required for the 1949/50 program must come from public budgets and private sources.

In the Soviet Zone a zonal budget which has replaced the five *Laender* budgets is prepared under the close supervision and direction of the SMA. Income generally exceeds expenditures by a considerable amount. About half the current revenue is transferred to the German Central Finance Administration which provides a great variety of subsidies for the support of the zonal economy. It covers the deficits incurred by the coal mining and other industries, maintains a ceiling on prices, primarily for state-owned enterprises, prevents price increases for foodstuffs, liquidates the debts of expropriated concerns, finances reparations and export deliveries, and provides for the reconstruction of factories. All this requires a very heavy tax levy. The five *Laender* budgets for the fiscal year 1947-48 anticipated a total revenue of RM 8.5 billion with total expenditures placed at RM 8.3 billion. Actual collection amounted to RM 8.9 billion, principally in consumers' taxes which accounted for 46 percent of total revenues compared to 17 percent from this source in the UK Zone and 22 percent in the US Zone. The zonal budget for 1948/49 was approximately the same as for the preceding fiscal year, but tax collections

were RM 9.2 billion, or nearly 5 percent greater than in 1947. This would indicate a general increase in industrial production, especially as the turnover tax remained at an occupation period high, and reflects Soviet efforts to obtain maximum benefits from the zonal economy. It is doubtful, however, if this high tax rate can be maintained in 1949 in face of the production difficulties occasioned by the cessation of East-West trade following the imposition of the counterblockade in July 1948 and the financial difficulties caused by currency reform.

(4) *Reparations.*

The plan for reparations and level of post-war German economy adopted by the Allied Control Council in March 1946 was based on the Potsdam Agreement providing for German unity. The objectives of the plan were:

- (a) the elimination of the German industrial war potential;
- (b) the provision of reparations out of Germany's capital equipment for victims of Nazi aggression; and yet to
- (c) leave within Germany necessary plants and equipment to permit rebuilding of a viable, peaceful economy.

Because of Soviet intransigence little could be accomplished toward the objectives of the plan on a quadripartite level; therefore, the US and UK Zones of Germany were fused for economic purposes in January 1947. On the basis of industrial capacity scheduled to be retained under the Reparations Plan of March 1946, it soon became evident that the Bizonal area could not become self-sustaining, and in August 1947 the US and UK announced a revised level of industry for their zones of Germany, to approximate the level of industry prevailing in 1936, an increase of about one-third over the level contemplated in the original plan. In October 1947, the US and UK announced a list of 683 plants and part plants which were surplus to the new industry level and therefore available for reparations.

Reports of US Congressional Committees on the desperate situation of the German economy and pending legislation for the European Recovery Program brought increased agitation for cessation of reparations deliveries. It

was feared that the elimination through reparations of equipment which could be of help to the economic recovery of Germany would undermine the recovery program. Further, the US Congress objected to reparation deliveries to the USSR of materials which assist in the development of war power.

Before its 1947 Christmas recess the Congress passed the Foreign Aid Bill without specific restrictions in the matter of reparations, but made clear that the question of plant removals would receive detailed consideration by the next session of Congress.

The breakdown of the Allied Control Council following the walk-out of the USSR in March 1948 eliminated all possibility of four-power agreement on reparations matters. In April 1948 all deliveries from the US Zone to the East were halted "pending clarification of certain issues." At the same time, the US Technical Mission, under cover of secrecy, went into western Germany to study dismantling and the reparations program as they related to European Economic Recovery and the development of the Soviet war potential.

After ERP came into being, the US took the position that it was desirable to re-examine certain portions of the reparation lists with a view to determining the extent to which some of the plants might better serve the needs of European recovery if left in Germany than if removed and re-erected elsewhere. A survey of the situation was consequently undertaken late in 1948 by a committee of US steel experts; meantime dismantling on a limited scale went forward in the French and US Zones.

The report of the Humphrey Committee became the basis of negotiations at London early in 1949 that resulted in the signing of an agreement on 31 March on Prohibited and Restricted Industries, under which it was agreed to retain in the German economy all but 9 of the 168 plants scheduled for dismantling but listed by the Committee as essential to the recovery program. Restrictions were placed on the production of ball bearings, primary aluminum, chlorine, and a few other products. Steel capacity was limited to 11.1 million tons per year, and all remaining capacity was to be allocated to IARA for distribution among its

members. The synthetic rubber and fuel industries were placed on the prohibited list, and all except a few of their installations ordered removed. Seven shipyards were also ordered removed, and German shipbuilding was restricted to the capacity that remained, subject to certain other limitations on the possible size and speed of the vessels to be built. The provisions are subject to review not later than 1952.

e. International Trade.

Before World War II a large foreign trade was one of the contributing factors to Germany's position as the most industrially powerful nation in continental Europe. Conversely, German exports and imports were of great importance to European economy. In 1936, for example, 11.4 percent of Germany's total industrial production was exported. Of total industrial exports, 75 percent came from the mining, metal-working, and chemical industries and only 25 percent from consumers' goods industries. About 16 percent of the total value of hard-coal output was exported, 23 percent of the machine tools, and about 25 percent of the output of chemicals. At the same time Germany was dependent on imports for a large part of its food supply and industrial raw material needs.

In normal prewar times Germany was one of the two major links (the other being the UK) in the pattern of trade and trade settlements in Europe. In contrast to the UK, which had a large import surplus from Europe, Germany had a large surplus of exports to most other European countries. These countries were able to settle their German accounts with pounds sterling, receipt of which allowed Germany, in turn, to maintain a large surplus of imports from overseas suppliers of raw materials. The world-wide depression and the Nazi rearmament program altered this situation, and Germany developed a system of administrative controls involving barter trade, import-export quotas, multiple exchange rates, and export subsidies, for the purpose of attaining planned trade objectives. Owing to the shortage of foreign exchange, the import program was restricted to essential foodstuffs, raw materials, and other com-

modities essential to the military program. Total value of foreign trade declined from RM 27 billion in 1929 to RM 10.6 billion in 1938. Although the major part of Germany's exports went to the industrialized countries of Europe, Germany was the most important source of supply of manufactured goods for central and eastern European countries.

From the outset of the postwar period the revival of the foreign trade of Germany, so essential to the recovery and maintenance of internal economic stability, encountered great difficulties. The business community of no other European country was so completely isolated from the rest of the world, and no other country dependent upon foreign markets and supplies was equally handicapped in its facilities for carrying on foreign trade. The whole complicated institutional system required for sales abroad disappeared to be replaced by the cumbersome postwar foreign trade administration, over which a series of Military Government controls was imposed. This change further retarded trade recovery.

The Potsdam agreement provided for the creation of a central German administrative department for foreign trade. On 15 August 1945, a quadripartite Export-Import Subcommittee was created, and an interim plan was developed in line with the provision of the Potsdam agreement that imports were to be restricted to goods necessary for minimum standards of consumption and production. Implementation of the plan was, however, left to the respective zone commanders.

The difficulties of quadripartite discussion finally led the Military Governments to foreign trade planning on a unilateral basis. During 1946 it became apparent that neither the US nor the UK Zone would become self-sustaining without a concerted effort to stimulate exports and simplify trade procedures. The Byrnes-Bevin agreement, dated 4 December 1946, provided for the economic integration of the US and UK Zones (the French and Soviet Governments having declined to participate) and for the creation by 1 January 1947 of a Joint Export-Import Agency (JEIA). This agency was charged with the collection of proceeds from export sales and the billing and accounting for all exports and imports,

in addition to planning the foreign trade program and supervision of trade relations with other countries. Finally, on 18 October 1948, the French Military Governor signed an agreement with the US and British Military Governors, to merge the foreign trade of the US, British, and French Zones of Occupation in Germany.

(1) *Bizone.*

Before the war, steel, metal goods, machinery, and chemicals constituted about two-thirds of the exports of the Bizone. Because of restrictions on war-potential capacity and shortages of power, manpower, and transport, such formerly important export items as machine tools, roller bearings, and heavy machinery generally have not been produced in large quantities. Hence, the character of the Bizone's postwar exports, limited as they have been chiefly to raw materials, has thus far borne little resemblance to the prewar pattern.

The European Recovery Program assumes the ultimate achievement of an export surplus to the other participating countries. The extent of the increase in importance of manufactured goods in the export program is evident: "coal, timber, and scrap" declines from 57 percent of total exports in 1948-49 to 31 percent in 1951-52, the compensating increase being in the manufacturing fields, chiefly machinery and equipment. The Bizone is expected to supply the need in ERP countries for a wide range of replacement and maintenance parts for German machinery, especially agricultural, food-processing, and mining machinery.

The extent of the progress necessary if the Bizone is to balance its foreign payments accounts by 1952 without extraordinary outside assistance is indicated in the following figures. For the fiscal year 1948-49 the Bizone relied upon outside assistance to cover a current account deficit in its balance of payments of \$1,041 million, of which \$404 million represented ECA grants and the balance the occupying powers' (chiefly US) "GARIOA" appropriations (for the prevention of "disease and unrest") for food, fertilizer, seeds, and petroleum products. ECA estimates for 1949-50 a

SECRET

current account deficit of \$892.5 million of which about \$476 million is to be met by GARIOA appropriations and \$302.5 million by ECA grants.

On 1 May 1948 a long step was taken toward normal foreign trade transactions. On that date a conversion rate of 1 RM=30 cents was established for German currency, consonant with the currency reform effected internally shortly thereafter. Under the early quadripartite agreement to maintain the 1936 price freeze instituted by Hitler, the German price structure had come to bear no reasonable relation to world market prices. Since JEIA had complete control of foreign trade, the problem of pricing exports was handled by administrative decision. German firms offering to JEIA goods for export were paid in German currency at the domestic ceiling price and JEIA sold the goods abroad for dollars at as favorable a price as possible. This arrangement discouraged exports in two ways: (1) there was no price inducement for Germans to offer goods for export; and (2) most potential foreign buyers, being short of dollars, tended to limit their purchases from the Bizone. The pricing of imports was handled in a similar way. JEIA paid the world market price in dollars and charged the German importer the internal ceiling price in German currency. Since the new conversion rate was established in May 1948 the isolation of German internal prices from world prices has largely ended. Since 1 May 1948, the conversion rate of one mark to 30 cents has applied to all exports except coal and to all imports except staple foodstuffs. In the case of exports, however, if the price obtained and converted into marks at the 30-cent rate fell short of the domestic ceiling prices, the difference was paid by JEIA as a subsidy to the exporter.

On 1 December 1948, JEIA controls were reduced to a minimum under new regulations permitting German businessmen to deal directly with foreign buyers or sellers without going through JEIA. Although considerable leakage of foreign exchange is believed to have resulted from the relaxation of JEIA controls, there is no doubt as to the stimulating effect of the simplified procedure on the Bizone's export trade. With the establishment of the

west German government, trade control and export license functions were transferred to agencies of the federal and *Laender* governments under the nominal supervision of the High Commissioners.

Reflecting the rapid industrial progress of the Bizone since June 1948, and also the improved export procedures, exports increased from \$91 million in the first quarter of 1948, to \$265.8 million in the first quarter of 1949. Of total imports of \$387 million during the first three months of 1949, \$142.5 million were financed with the proceeds of exports, \$135.3 million by US/UK appropriations, \$109 million by ECA funds.

(2) *French Zone.*

The present French Zone is poor in basic raw materials and resources as compared to the Bizone. Before the war the area now comprising the French Zone paid for needed imports of grain, coal, steel, cotton, hides, and various other industrial raw materials by exporting agricultural products (wine, tobacco, meat, potatoes, fresh fruit, and vegetables) and manufactured goods (chemicals, shoes, textiles, and time pieces). The area also had a large timber industry, and exported lumber and wood products. Trade was chiefly with the area now included in the Bizone.

Although the postwar agriculture and industry of the French Zone suffered from direct war damage and reparations, one of the chief causes of its stagnation was the disruption of its trade and the consequent lack of raw materials.

Since the war, more than half the total exports have gone to France, whose needs have been the paramount consideration in determining the character of this trade. In return for exports of lumber needed for French reconstruction, and some food, needed in the Saar, the Zone has received Saar coal and food imports from the US, paid for by France. Food, coal, and potash fertilizer have been obtained from the Bizone in return for lumber, small amounts of meat and tobacco, potatoes, and nitrogen fertilizer. Nevertheless, food imports have been barely sufficient to ward off starvation, and coal has had to be diverted to non-industrial uses.

SECRET

In contrast to the Bizone, the French Zone did not have the benefit of substantial assistance from the occupying power, and has suffered in addition from occupation troops "living off the land." In 1946, total exports from the French Zone were \$60 million, three times the value of exports from the US Zone over a longer period of time. All but a small proportion, probably less than 20 percent, of this trade went to France. Certain plants worked exclusively for the so-called export program and were accorded preferential treatment in the supply of power, coal, and raw materials as well as in the allocation of cigarettes and food. Exports continued to increase and reached \$106 million in 1947, of which \$88 million went to France. The largest zonal exports to France consisted of lumber and lumber products, and constituted 38 percent of the total. Imports amounted to \$13 million, of which 37 percent came from the US, mostly in foodstuffs. Rising world prices for imports turned this favorable trade balance into a deficit of 1948. In the first six months of 1948, bizonal receipts from the French Zone were RM 54.6 million, while deliveries from the Bizone were RM 196.3 million.

During 1948 steps were taken to integrate the foreign trade of the French Zone with that of the Bizone through the JEIA, culminating in a fusion with the Bizone on 18 October. As a result it became necessary to provide direct outside assistance. For the fiscal year 1948-49, ECA grants to the French Zone amounted to about \$100 million, to cover expected dollar deficits. ECA estimates dollar aid requirements for 1949-50 at \$115 million.

Even under the most optimistic assumptions as to production and distribution of indigenous food supplies, imports of breadgrains will continue to be needed to supply about one-half of the bread ration and one-fourth of the total caloric intake of the population. Manufacturing industries, however, are expected by the last year of the ERP to have recovered sufficiently to provide a net export surplus to Western Europe.

(3) *Soviet Zone.*

The USSR consistently blocked agreement on quadripartite allocation of foreign exports

from Germany and veiled the export transactions of the Soviet Zone in secrecy. Lists of commodities to be exchanged are published, but little information is given about the actual volume or value of the trade. The USSR is always the principal beneficiary of such foreign-exchange proceeds as are realized from Soviet Zone exports. This does not include reparations which constitute the largest part of goods removed from the country. In 1948 and 1949 the Soviet Zone concluded trade agreements with a number of foreign countries, including Belgium, the Netherlands, Sweden, and Poland. The export-import deals negotiated within the framework of these agreements are largely handled by the Soviet-established German Central Administration for Foreign Trade, the purpose of which, as stated by the USSR, is to stimulate the expansion of export trade, particularly toward the Soviet Union, Poland, and the Danubian states. Outside of these trade agreements a relatively large share of German export trade is conducted through a number of Soviet-controlled export companies, with the compensation goods or foreign exchange proceeds benefiting the Soviet rather than the German economy. The principal items of export are potash, which the Soviet Zone possesses in abundance, timber, scrap iron, machinery, and chemicals. Chief imports since the lifting of the counterblockade in May 1949 are raw materials including cotton, wool, machinery and parts, semi-finished steel products and chemicals for state-owned enterprises producing for the Soviet account.

Although the USSR planned an ambitious foreign trade development program for the Soviet Zone in 1948, fulfillment was seriously curtailed by the imposition of the Western Powers' counterblockade and by the ensuing production difficulties arising from shortages of vital materials previously obtained from the western zones. It was the intention of the USSR to channel the great bulk of Soviet Zone trade eastward, but the satellite countries proved unable or unwilling to exchange commodities with the Soviet Zone in the quantities or types required by the zonal economy. Consequently, an unfavorable balance-of-trade developed, with imports exceeding ex-

ports (excluding reparations payments) by a considerable amount, and the USSR contributing heavily for the first time from its own stocks to maintain the faltering economy of the zone. Zonal imports for 1948 were RM 356.2 million, of which the USSR contributed RM 88.2 million; and exports were only RM 274.2 million, of which RM 40.5 million went to the USSR. Although this trade was considerably in excess of the total 1947 foreign trade, its distribution is significant in view of the East-West controversy. Less than one-fourth of the imports were from Western Europe, and exports to that area were correspondingly small. Imports in the first quarter of 1949 appeared to have increased about 50 percent over the 1948 rate, while exports increased over 95 percent.

In 1948 the Soviet Zone sent about RM 104 million worth of goods to the Bizone and received from that area about 140 million RM worth. Much of this was raw material and about 85 percent of it was shipped before August when the counterblockade went into effect.

3. Economic Stability

a. *Western Zones.*

During the first two years of Occupation, conflicting Allied policies served only to deepen the confusion and uncertainty which their material assistance was intended to correct. In view of the low levels of production attained, the worthlessness of the currency as a measure of relative values, and the low level of foreign trade, only strict rationing of necessities and stringent price, wage and rationing controls prevented the economies of the several zones from deteriorating.

The Soviet action in breaking up the Allied Control Council on 20 March 1948 may have put a permanent end to quadripartite efforts to forge an economic entity of Germany; nevertheless, it released the western zones from the baneful effects of Soviet tactics obstructive to economic recovery. The western Allies countered the Soviet action by moves aimed at increasing production in the western zones, beginning with the currency conversion in June. This step alone resulted in the re-

lease of hoarded goods and in a steady increase in production in the western zones. A level approximately 88 percent of 1936, attained in May 1949, was maintained during the summer months.

Important among the factors which obscure the outlook for further recovery in the western zones is the question of future control of the area containing most of the steel industries and hard coal deposits—the Ruhr. The US and UK decided on 10 November 1948 to give temporary management of Ruhr industries back to the Germans. This decision allows German trustees to operate the industries until the new German Government in the western zones acts to socialize them or to return them to private ownership. The decision was made in the belief that increased production would result, that this in turn would relieve US and UK taxpayers of occupation cost burdens, and that it would ensure a maximum contribution from western Germany to recovery in Western Europe. French concern regarding a too rapid revival of German industry was partially allayed by a six-power agreement reached 28 December 1948, establishing an International Authority for the Ruhr with power to control minimum export allocations of coal, coke, and steel from the area. The agreement was signed and went into effect on 28 April 1949 amid German fears that the area was permanently lost to the German economy.

Numerous other factors cloud the economic future of the western zones. To the extent that the area continues to be cut off from the foodstuffs, raw materials, and manufactures of eastern Germany, it must remain the more dependent upon foreign trade. The prospects for the attainment of prewar levels in trade with eastern Europe are not bright. Trade with the West, although contingent upon the continued success of the ERP, will probably improve.

Further increases in production in the western zones is being hampered by an inadequate investment program and by the unsettling effects of the necessity for reorganization of the tax system and division of responsibilities between the lower levels of government and the new central government. New capital

SECRET

goods are badly needed, but foreign investors are reluctant and the internal economy is not able to provide funds necessary for the purchase. Labor unrest, strikes, and a reduction in the productivity of labor are encouraged by the need for further tax reform, broad-scale domestic readjustments in prices and wages, and a reduction in occupation costs.

Factors favorable to improvement in the economic situation are the continuing ERP aid to western Germany and to Western Europe and the fear of Soviet expansion, a fear which strengthens morale in the western zones and is conducive to German support of Allied efforts to improve economic conditions. Germany also possesses a reservoir of highly skilled labor, great technical skill and ingenuity, and a will to dominance in all fields which should assist in overcoming the obstacles now hampering economic recovery.

b. Soviet Zone.

Despite the Soviet currency reform in June 1948, production in the Soviet Zone declined in subsequent months. The decline there was in part attributable to Soviet removals without compensation of both current output and plant equipment. In part also the Soviet blockade of Berlin was responsible, since in re-

taliation for the blockade the western Allies promptly embargoed the shipment of goods from the western zones to the Soviet Zone.

With the lifting of the counterblockade in May 1949, there was a revival of industrial output, although it is doubtful if quotas under the Two-Year Plan can be met in view of continuing shortages. The full restoration of interzonal trade relations may see further improvement in eastern German economic conditions. There is slight indication, however, that further improvement in general production levels will improve the general public's consumption standards. Gains will be registered only in those industries and for those groups favored by SMA. The area as presently bounded is not self-sufficient in foodstuffs. The area, moreover, normally imported coal and manufactures from western Germany and elsewhere. The satellite countries are not able to provide substitute supplies, because their surpluses (except for Polish coal) are channeled to the USSR or are traded within the Soviet orbit. There is evidence that this economic outlook gives less concern to the SMA than the development of governmental organization and controls similar to those of the Soviet Union.

SECRET

11-35

RECEIVED

1950 MAR 07 13 23

CIG/URE

10

11

12

CHAPTER III

MILITARY SITUATION

1. Origin of the Present Military Situation.

The 1939 German Army was created from the entire economic, political, and psychological resources of the German people by an authoritarian government which devoted a large part of the national energies both to the study and to the application of the science of war. By complete and scientific control, the nation was coordinated for the purpose of aggressive warfare. Furthermore, the military tradition was deeply ingrained in the character of a people accustomed by a rigid caste system to servile obedience to the voice of authority and fanatically predisposed to follow strong nationalist leaders in peace as well as in war.

The basis of the German military system was compulsory military training, introduced by Prussia in 1814, and adopted by other German states. After the unification of Germany in 1871 compulsory military training was decreed for the entire Reich. As a result of this system, the Second Reich could put 3 million trained troops into the field in 1914 simultaneously on two fronts. Conscription was forbidden by the Treaty of Versailles, and the size of the army was limited to 100,000 troops enlisted for a period of 12 years, an arrangement designed to prevent the creation of a large reserve of trained men. Germany evaded this stipulation, however, by using the small army as an officers' training corps, while various paramilitary organizations, such as State Police units, athletic clubs, and other groups, furnished many Germans with basic military training using weapons borrowed from the army.

The German economy was left physically intact by World War I, and the war potential of industrial plants was expanded concurrently with the development of the new *Reichswehr*. German technical research in military

weapons, aircraft, submarines, and naval craft went on apace in neighboring countries such as the Netherlands, Switzerland, and Russia, where facilities were either made available to the Germans or allowed to come under German control in the period preceding 1933.

The old army administrative organization was also preserved after 1918, making it a relatively simple matter for the Nazis to undertake the remilitarization of Germany openly after Hitler's advent to power. The peacetime German Army was based on the division of the country into 8 corps areas, each self-contained and capable of handling all military matters within its jurisdiction. After the Polish campaign of 1939 two new corps areas were created in the annexed eastern territory. In 1935 the Nazis reintroduced conscription with one year of active service for which able-bodied Germans between the ages of 18 and 45 became liable after which a soldier passed into the active reserve until the age of 35, and then became a member of the *Landwehr* (Reserve) until the age of 45.

In four years under this system the German Army was expanded from 7 divisions to a total of 51 divisions plus corps troops. The new German Army consisted of 36 infantry and motorized divisions, three infantry divisions in the Austrian and Sudeten areas, five *Panzer* (armored) divisions, four light divisions, and three mountain divisions. Before mobilization in the fall of 1939 the German Army numbered 700,000 men with a trained reserve of more than three million.

The German Navy was developed much later than the army, and although equally efficient, was by no means as powerful. In every respect the navy was subordinated to land requirements and considerations. German submarines conducted a devastating campaign in both World Wars. The principal strategic

value of the German surface fleet, however, was to contain important elements of the British fleet. After the first World War the German Navy was drastically reduced in size, the High Seas Fleet being surrendered to the Allies and eventually scuttled by its crews, while the construction and maintenance of submarines was prohibited. Germany subsequently circumvented treaty limitations on the size of naval vessels by building commerce raiders popularly known as pocket battleships, which were high-speed armored cruisers armed with 11-inch guns and which exceeded the limit of 10,000 tons. In 1935 Great Britain agreed to allow the Germans to build to a level of 35 percent of the British fleet, with the right, within this total limitation, to submarine tonnage equal to that of the British.

The German Air Force (*Luftwaffe*), on the other hand, was organized in 1935 and administered independently of either the army or the navy. Its three functional branches were air tactical units, anti-aircraft artillery, and air signal troops. Under the air tactical units were included parachute and airborne troops, air engineers, air medical units, and a number of special divisions formed in 1943 of air force personnel for service as regular fighting troops. This division of responsibility resulted in a high degree of mobility among the flying units and was responsible for much of the early success of the German Air Force during the war.

Because of the high degree of mobility and mechanization achieved in the entire German Army by 1939, Germany could initiate a war of movement. It quickly overran Poland (1939), most of Western Europe (1940), and a good part of Russia, the Balkans and North Africa (1941-42). As the war expanded in scope, however, mounting casualties and increased commitments obliged the Armed Forces to reach into both the younger and older age groups for replacements. "Total mobilization" was carried out in the spring of 1943 after Stalingrad, and physical standards for military service were lowered drastically. Even the Hitler Youth was called up as auxiliaries. The final months of the war saw Germany scraping the bottom of the manpower barrel as almost the entire population, regard-

less of age or sex, was drafted into some form of service in a desperate effort to avert the impending collapse. By the end of the war the German military machine had disintegrated, and steps were immediately taken by the Allies to insure that it would remain that way.

2. Strength and Disposition of Armed Forces.

The Potsdam Agreement provided for the complete disarmament and demilitarization of Germany and the elimination or control of all German industry that could be used for military production. To these ends it was directed that:

All German land, naval, and air forces, the S.S., the S.A., S.D., and Gestapo, with all their organizations, staffs, and institutions, including the general staff, the officers' corps, reserve corps, military schools, war veterans' organizations, and all other military and quasi-military organizations, together with all clubs and associations which serve to keep alive the military tradition in Germany, shall be completely and finally abolished in such manner as permanently to prevent the revival or reorganization of German militarism and Nazism.

All arms, ammunition and implements of war and all specialized facilities for their production shall be held at the disposal of the Allies or destroyed. The maintenance and production of all aircraft and all arms, ammunition and implements of war shall be prevented.

To carry out Allied objectives and to insure compliance with Potsdam policies, Germany was divided into four zones of occupation with an Allied army in each zone. In practice, all phases of German life were under the absolute control of the military commander in each zone. Matters affecting Germany as a whole were decided jointly by the four Allied Commanders-in-Chief, who formed the Allied Control Council in Berlin. Theoretically, this Council was also charged with the responsibility of insuring a uniform application of Allied policy in the four zones. The entire cost of the occupation was to be borne by the German people pending the unification of the country and the withdrawal of the Allied forces. In the US Zone, headquarters for the US Commander-in-Chief were set up at Frankfurt-am-Main, and US troops were quar-

SECRET

III-3

tered throughout the three *Laender* and later in the Bremen Enclave.

Western Allied forces in Germany are not under a unified command. As of 1 September 1949, the US had 80,000 Army personnel stationed in Germany as the Army of Occupation. In addition, a German police force of 41,700 men has been formed and armed under US supervision. Occupation ground forces in the UK Zone numbered 78,400, of which 21,400 were Belgian, Danish, and Norwegian. The British also maintain a German police force of 41,930 men. In the French Zone, there were 48,000 ground troops and a French Gendarmerie of 54 men. German police in the French Zone total 7,490.

US Air Force combat strength is composed essentially of three F-80 jet fighter squadrons, three F-47 conventional fighter squadrons, and a small number of light bombers, reconnaissance, and other special purpose aircraft. In the UK Zone, the Royal Air Force had as of 15 September 1949 three Vampire jet fighter squadrons, two conventional fighter squadrons, one reconnaissance squadron, and four light bomber squadrons. On the same date, the French in their zone maintained two F-47 conventional fighter squadrons, one of which, presently in transitional training, is expected to return to Germany equipped with jet fighters, and two reconnaissance squadrons.

The Soviet forces represent the largest and most formidable force in Germany and are under unified command. As of 1 September 1949, they consisted of four rifle, eight tank, and ten mechanized divisions, a total of 355,000 army and SMA troops, in addition to which there were 20,000 political police (MVD troops) and 3,000 naval troops. The Soviet Air Force in Germany, represented chiefly by the 16th Air Army, was estimated on 15 September 1949 at 30,000 men and 1,300 to 1,400 aircraft, including 800 conventional fighters, 400 to 500 light and attack bombers, and 60 to 70 reconnaissance aircraft. The total of all Soviet troops is thus approximately 408,000 men.

Besides its own forces, the USSR is expanding the German police organization of the So-

viet Zone. The central German police agency is the German Administration of the Interior, which has the following executive organs:

a. The paramilitary German police, composed of the Border Police and the *Bereitschaften* or *Kasernierte* (barracked) Police. Army Intelligence Division estimates of 1 September 1949 place the strength of the Border Police at 12,000 and the *Bereitschaften* at 15,000. Reports that the paramilitary police are now being trained and equipped with heavy weapons, including mortars, artillery, and armored vehicles have increased rapidly since August 1949, but are as yet not definitely confirmed.

b. Although the present ratio of the *Ordnungspolizei* (regular police) to the population is not known, total German police strength, including the paramilitary police and the political/criminal police, is estimated at 100,000 as of 1 September 1949. In relation to the German population of the Soviet Zone, the ratio is about 1:178. The Soviet Zone police are drawn for the most part from prisoners-of-war held within the USSR and the graduates of the Antifa schools. The long-term reliability of such personnel to the USSR is questionable, despite the intensive Communist indoctrination they have received. Key positions in the Soviet Zone police are held by veteran German Communists.

Former German officer and enlisted personnel held captive in the USSR have been subjected to political indoctrination, placed in labor battalions, given Soviet training for administrative posts and police work, and in some instances organized into combat police units. While such groups do not constitute an army in the accepted sense of the term, they might be valuable in a paramilitary capacity if no conflict with German loyalty were involved. The USSR has retained a large number of German prisoners chiefly for their labor, which they perform over wide areas of the USSR, and also to serve in whatever regime the USSR may eventually establish in Germany. The long-term fidelity of such personnel to the USSR is doubtful.

SECRET

At the end of the war, Germany (including Austria) had approximately 8,200,000 men * under arms, all of whom the Allies immediately demobilized. Since 1945, these veterans have had no training, and many have passed into over-age categories. There are no reliable records on current fitness or age groups, yet on the basis of population statistics, western Germany has a reservoir of approximately four million able-bodied men capable of military service and eastern Germany approximately two million. German manpower in

the past has proved itself docile, obedient, intelligent and courageous; and German armies have been the best on the Eurasian continent from a military point of view.

An estimated one to two million former German soldiers have not returned to Germany. With the exception of about one hundred thousand who have voluntarily remained in France and other Western European countries as paid laborers, these are in the USSR and the satellite states. Of the total holdings of German PW in these countries, estimated at over 3 million at the end of the war, around 960,000 have been repatriated so far. It is believed that no more than 240,000 can be expected to return home. The rest are either dead or will be retained indefinitely to perform labor service.

* Estimated gross mobilization	17,900,000
" killed	2,750,000
" disabled and discharged	1,050,000
" prisoners	12,900,000
" escaped apprehension	500,000
" hospital pool	700,000

SECRET

CHAPTER IV

STRATEGIC CONSIDERATIONS AFFECTING US SECURITY

1. General.

As the major point of contact between the policies and physical forces of the US and the USSR, Germany plays an important role in the East-West struggle in Europe. Because of its geographic location, because it is incapable of self-defense, and because it is not as yet formally committed to either side, Germany is of utmost strategic significance to the US.

Germany is the most important point at which the westward expansion of Communism can be contained physically. At present it is subjected to diametrically opposed policies based on the ideological differences between the US on one hand and the USSR on the other. It will continue to be the scene of this East-West battle for the predictable future. In this cold war the mass of German people are on the side of the US, not from any great admiration for American ideals or institutions, but from abhorrence of Communism and fear of Soviet political objectives. Foreign occupation, the disappearance of the German Army, the disorganization following total defeat, and the removal of much of the national war potential have reduced the Germans to the status of relatively powerless observers in this struggle to determine their ultimate destiny. Under present conditions, it is doubtful that the Germans would render effective support to one side or the other in the event of actual conflict with the exception of providing trained military manpower. Whether or not they would be willing to take an active part in such a war is problematical at this time, although a considerable number of Germans have indicated their willingness to defend their country against the Soviets. On the other hand the Germans are determined to regain as much of their former territory as conditions will allow, and few Germans, given the

opportunity, would hesitate to play off the US against the USSR in an endeavor to achieve unification on their own terms. Although Germany possesses trained manpower, technical ability, and a considerable residue of industrial potential, it is unlikely that western Germany can at present, afford the US effective support in case the present East-West conflict cannot be resolved peacefully.

The success of the US policy of containing the USSR within its present sphere of expansion is conditioned to a large extent upon a revived and strengthened western European economy. Western Germany is expected to make a considerable contribution to European recovery if its levels of production can be raised to approximately the levels of 1936. With adequate supplies of food and raw materials, it is hoped that this goal will be attained by 1952. As long as manufactured goods remained a relatively small part of bizonal exports which were principally coal and coke, timber and scrap, these contributions to European recovery exerted a depressing effect upon the internal western German economy. As production of consumer goods revives and the standard of living increases, western Germany can make a sounder contribution to European markets and to the more economic use of European resources.

The cost to the US of putting the western German economy on a viable basis is great, but the only alternative is to maintain the population on a minimum relief standard of living as long as the US occupation lasts. While \$416 million were allocated to the Bizonal Zone and \$92 million to the French Zone in the first year of the ECA program (1948-49), the output of consumer goods increased substantially, as did exports in this category, but the increase was far short of satisfying domestic requirements, and the standard of liv-

SECRET

IV-1

ing although improved is still far from normal.

German reaction to the ECA program was mixed. There was some fear that it might facilitate a permanent split between eastern and western Germany. Even now the Socialist elements among the population, who polled 29 percent of the popular vote in the recent elections in western Germany, are concerned lest too great an orientation toward the US would result in an abandonment of socialist reforms and a planned economy. Some right-wing elements feel that US aid is being manipulated to their disadvantage. In general, however, Germans accept the program with mental reservations, and its ultimate success depends upon the degree of cooperation which improving conditions or lack of them may inspire.

The question of western Germany's position in the contemplated Western European defense system has so far not been subject to formal discussions among the Western Allies. The policies of the Western European powers, notably France and the Benelux countries, based as they are upon fear of a resurgence of German military aggression, preclude the remilitarization of Germany or its integration into any such system in the near future.

2. Political Factors.

The reconstruction of the German political system along democratic lines has been initiated by the Western Allies. The Germans themselves have been lukewarm or passively receptive to the program laid down for their political guidance. Many German leaders continue to be apprehensive of being stigmatized as "collaborators" for supporting a system imposed upon the people by their conquerors. New leaders of marked ability have not appeared, and German political parties have been content to wrangle among themselves for the privilege of holding office while holding the Western Powers responsible for the economic rehabilitation of the country. Inability of the Western Allies to agree upon implementation of major policies, as well as passive resistance on the part of German officials to Allied occupation policies considered

harmful or unfair to German interests, has been consistently exploited to the detriment of US prestige, both by Communist and ultra-rightist propaganda. In eastern Germany, dissatisfaction with Communist rule continues to exist. As the Communist control mechanism tightens its grasp on the population, however, present hostility to the USSR and its German collaborators will ultimately become apathetic acceptance of the *status quo*.

Germany is not unified and it has no central government. The regimes in both eastern and western Germany will remain generally stable, apart from possible personnel changes. There is no likelihood that these governments will be overthrown in eastern or western Germany by revolution or by violence from a domestic source. Nationalistic elements are yet in the nebulous stage of development, and in western Germany subversive elements such as the Communists are too weak and ineffective to constitute a threat.

The west German government is, of necessity, obliged to cooperate generally with the US, because of its dependence on US military and economic support. The Germans, however, will not allow this dependence to interfere with attempts to attain long-range goals such as autonomy and German unification. The Federal Government is sure to press for admittance into various European organizations of a non-military nature and ultimately for admittance to the NAP. In addition, the government will consistently circumvent or ignore Allied controls where they are felt to be harmful to German interests.

The withdrawal of the Western occupation forces would not be welcomed by most Germans under present circumstances. If they were freed from outside pressure or interference in internal affairs, they would at present be less able to maintain a stable form of government. A premature withdrawal would, moreover, serve to increase the power of the Communist party in western Germany. The existence of the present western German Government might ultimately be jeopardized by the attitude of nationalistic elements seeking to achieve their objectives through collusion with the USSR. It is unlikely that the USSR would withdraw all troops from the Soviet

Zone until Communist control of eastern Germany had been perfected.

In view of Soviet policies and geographic proximity a limit to US occupation of western Germany cannot be foreseen. Much is dependent upon the establishment of a viable economy, and Germany has a long way yet to go in that direction. Once this is assured, however, it is possible that the Federal Government may successfully resist Soviet efforts at domination provided strong US military, political, and economic support continues to be available, and that Germany does not develop a type of reaction leading to a revival of militarism or an orientation toward the USSR.

3. Economic Factors.

German recovery will require years to overcome the effects of war damage and the general dislocation to life and property. For the indefinite future it will be necessary to supply western Germany annually with \$3 billion worth of food and raw materials, for which only partial payment can be obtained from exports. More than a third of this amount will be required for foodstuffs, because indigenous food supplies are sufficient for less than half the population. Western Germany will be unable to maintain minimum ration requirements unless there is a surplus of commodities for export. The German economy will have great difficulty in producing for export and at the same time satisfying the demands of the domestic market. Efforts to raise the level of German industry to the point where it will provide the volume of foreign trade necessary to balance the required import program are hampered by Western European fears of again placing German industrial potential in a predominant position on the continent. A more immediate bar to industrial expansion as well to the reconstruction of war-damaged areas is the absence of capital for long-term investment. Lack of repair and replacement parts, shortages of electric power, and inefficient methods of operation resulting in high production costs are other impediments to rapid economic recovery, in consequence of which no important industrial targets were met in 1948. The transportation

system has been restored to about 70 percent of the prewar volume of traffic, which allows for present needs but not for the major reconstruction necessary for a progressive expansion of industrial output. Foreign trade is hampered by the inaccessibility of former markets and sources of supply, while the absence of a merchant marine is another source of weakness in the restoration of the western German economy. Although the beneficial effects of currency reform have by no means spent themselves, industrial production must expand rapidly to prevent the development of another inflationary cycle. Enough money is in circulation to create an effective demand for the limited quantity of consumer goods, and this strong internal demand exerts a retarding influence on west German exports.

The Ruhr is the keystone of the German economic system, and its future development under IAR also holds the key to European strength and stability. Apart from enormous reserves of high-grade hard coal, the Ruhr is deficient in all other resources and requires a steady flow of raw material imports in order to keep its industries operating. Strategically, however, the possession of this highly integrated industrial area is of major importance in any military plan for the control or defense of Europe. Formerly the arsenal of Western Europe, the Ruhr has been withdrawn from German control and placed under international authority for the purpose of preventing a resurgence of German military aggression by allocating coal and steel exports according to the needs of a peacetime economy. Removal of this area from German sovereignty has caused widespread nationalistic repercussions and raised fears that the controls may be the means of eliminating Germany as a future competitor in world markets.

The USSR wants to participate in control of the Ruhr (1) to prevent it from playing its important role in strengthening Western Europe's economic and military position and (2) to give the Soviet orbit the benefit of its production, also for military and economic purposes. The USSR undertook to block or defeat all US efforts at reconstituting the German economy on a unified basis and denounced the US for refusing to acquiesce in

Soviet proposals that would have reduced Germany to the status of a satellite country. Soviet reparations demands have been an important weapon in preventing unification except on terms unacceptable to Western democratic interests. The Soviet attitude of delay and obstruction may be based in part on the assumption that the continued drain on US resources will hasten the anticipated economic collapse of the US and bring about the withdrawal of US forces from Europe. Every US step taken to improve the economic position of Germany as well as of Western Europe has been opposed by the USSR because such steps would strengthen US influence in Europe and check the expansion of Soviet power.

The rigorous Soviet policy of stripping the Soviet Zone for the benefit of the USSR has left eastern Germany in a poor economic condition. The alienation of a substantial part of the territory to Poland further weakened the economic potential of the area. What was once a surplus food region is now barely self-sustaining, while Soviet land reform has discouraged farmers and has resulted in poor harvests as compared to prewar years. Except for enormous potash deposits and extensive reserves of brown coal, the Soviet Zone is an economic deficit area dependent upon raw-material imports for the maintenance of its industries. Formerly, Western Europe and the western zones of Germany were the principal sources of supply, but the USSR reversed this trend in an effort to orient the Soviet Zone toward the satellite economies. This policy served only to aggravate an already serious situation. Neglect of the transportation system has reduced Soviet Zone railroads to a very low level of operating efficiency. Most of the canals have been rehabilitated, however, and a substantial part of the volume of freight traffic is water-borne. The highways are in poor condition, and motor vehicle transport is handicapped by lack of repair parts and shortages of gasoline and lubricants. Although the USSR has maintained the eastern German synthetic gasoline and synthetic rubber industries at about 50 percent of prewar capacity, the bulk of these supplies is stockpiled for the Red Army or shipped as reparations to the Satellites and the USSR;

little is diverted to the German economy. Other war-potential industries, mainly those manufacturing radar and electronic equipment, aircraft parts, tank parts, military vehicles, anti-aircraft guns, and ammunition; are operated to capacity on raw materials supplied mostly from sources under Soviet control. The output of consumer goods is far below the needs of the eastern German population.

Strategically, eastern Germany is being utilized as a source of manpower, technical and scientific equipment, raw materials, and finished goods for the USSR, and secondarily as a point of departure for a possible westward expansion of the USSR should that become feasible. A pattern of Communist-dominated control has been established for the area which is so widely divergent from that established under democratic auspices in western Germany that unification of the two sections is no longer feasible except on terms prejudicial to US interests. Although an eastern German state has been established, its stability is guaranteed only by the presence of the Red Army, while the limitations placed upon economic development by Soviet policies and practices have left the area too weak and exhausted to stand alone. Until the USSR reverses these policies and practices, there is little likelihood of much substantial improvement in the present situation and considerable danger of further deterioration.

4. Military Factors.

Germany has been completely disarmed under the Potsdam Agreement. The western zones possess no indigenous military or naval forces and no paramilitary forces of significance. In the Soviet Zone a para-military police force is being organized, primarily to insure internal Communist control, but with aggressive military potentialities depending upon the ultimate size, training, character, and indoctrination of the force recruited by the USSR. Its reliability at present is questionable, and the USSR, aside from satellite objections to a rearmed Germany, cannot afford to maintain a large armed force that one day may turn against it. Industrial war potential in western Germany has been partially

S E C R E T

IV-5

destroyed, and what remains could not be realized quickly in the event of war. In eastern Germany a large amount of industrial war potential was dismantled and shipped intact to the USSR along with the trained staffs to operate it. The remainder is employed to capacity in turning out war material on the Soviet account. The USSR also single-tracked all railway lines running east and west across the Soviet Zone as a defensive measure and dismantled much additional trackage. As a result, rail movement across eastern Germany is by no means adequate for large troop concentrations.

On the other hand, the rail systems of western Germany have been restored without concern for strategic implications, and, while far from efficient, are adequate for normal purposes. Restoration of the highway system has also proceeded further in the western zones than in the Soviet Zone, but in both areas motor vehicle transport is scanty, in poor condition, and dependent upon imports for at least 75 percent of requirements for POL supplies and spare parts. The Germans maintain no air force, military or commercial,

but former Reich landing fields and airdromes in both eastern and western Germany have been rebuilt and expanded by the occupation forces in each zone. During the second World War the German canal system moved about 30 percent of all freight, thus releasing the railways and highways for military purposes; this would be impossible under present circumstances.

There are no effective natural barriers in either western or eastern Germany to impede the movement of armies in the event of war or provide points at which local resistance could be organized for any length of time. Neither would any large-scale resistance movement materialize to hamper the operations of an invader. Strategically, the trizonal area offers a land mass scarcely 200 miles in width between Western Europe and the frontier of the Soviet Zone behind which lie the armies of the USSR and its satellites. The defense of western Germany would present almost insuperable difficulty to the US, while its invasion could be accomplished with little trouble by the USSR.

S E C R E T

CHAPTER V

PROBABLE FUTURE DEVELOPMENTS AFFECTING US SECURITY

Germany must be considered as an area of potential military action, not only because of the continuing possibility of an East-West war, but also because of the large occupation forces employed by the USSR in the Soviet Zone. Army units in the Soviet Zone are at about 70 percent of personnel strength, and 100 percent of equipment. Air units are estimated at about 80-90 percent of equipment and approximately the same percentage for personnel. Troop strength was increased by approximately 60,000 men in the spring of 1949, but no significant changes have occurred in troop dispositions. The proportion of recruits in the units in Germany is higher than it has been in the past. Morale is not especially good, however, and desertions from the Soviet Army over the Soviet Zone frontier occur at a rather high rate. It is the practice of the USSR to change its units frequently in order to prevent ideological contamination from too extended exposure to western culture. Such constant troop movements are somewhat misleading and afford a cover for a possible rapid concentration which might not be properly evaluated in the event of unannounced overt hostilities by the USSR. There has been no perceptible build-up of armor or supplies by the USSR, nor have the Soviets taken certain other measures which would normally indicate preparations for a military offensive.

Present Soviet policy appears to be directed towards avoiding international incidents involving a risk of war. Soviet establishment of an "All German" government formalizes the existing split in Germany and represents a Soviet attempt to counter the attraction of the West German Republic as a focal point of German hopes for unity. To enhance the appeal of the East German State, the USSR will probably give it the appearance of more in-

dependence than the West has given the West German State. The USSR will attempt to utilize the "All German" government to increase Soviet influence in all Germany, timing its actions to exploit the political rivalries and economic conditions in west Germany.

Inasmuch as developments in Germany have revealed to the USSR the low appeal of Communism to the Germans, the Soviets have, for the time being, probably resigned themselves to the fact that Soviet domination of all of Germany is a remote possibility. They have doubtless decided to adopt the long-range view of accomplishing their aim through eventual dissatisfaction of the western Germans with the occupation powers, their Government and anticipated economic reverses. The Soviets hope that this dissatisfaction will result in civil unrest and eventual ascent to power of Communists or nationalist elements favoring a unified Germany oriented toward the USSR. So far, Soviet propaganda assaults on US objectives in western Germany have had very limited success. The subversive influence of the German Communist Party (KPD) in western Germany has also been very slight. At present, Berlin constitutes the most exposed and vulnerable spot against which Soviet military and economic pressure can be brought. Soviet efforts to force the Western Allies out of Berlin, or at least to make their occupation of its western sectors a nominal one, by extending Communist control over the economic life of the city have so far been unsuccessful, but the threat to world peace and US security remains.

Before any consideration can be given to the inclusion of Germany into a Western European defense system, the western occupation powers wish to create in that country those conditions which would make it a reliable ally, thoroughly indoctrinated and prac-

ticing the concepts of Western democracy. In seeking to create a peaceful and democratic Germany on the ruins of the Nazi Reich, the Western Allies are confronted with persistent authoritarian forces within the country. Provided there is no war, it may in time be possible to accomplish this objective with ample moral and material assistance from the United States and an improvement in the mutual relationship between Germany and her Western European neighbors whose approach to the problem has hitherto been conditioned by distrust of Germany based on bitter experience in the past.

While every effort is being made by the Western Allies to rehabilitate Germany with a view to letting it take its place among other European nations, the USSR has pursued a policy of exploitation in its zone which has turned the population against it. It is believed, therefore, that the German people are inclined to support the United States which has pursued a more constructive and beneficial policy in their eyes. However, the possibility of a change in this western orientation of the German people and a future alignment of a unified and independent Germany with the USSR must not be disregarded as a possibility. Failure of the Federal Republic, disillusionment with the Western Powers, and hopes of greater advantages from the Soviet Union may eventually cause such a switch in German thinking.

In the present cold war for control of Germany, the USSR has the advantage of a more thorough control of its occupation area. Politically and economically the Germans in the Soviet Zone have been forced into the Communist pattern to the point where transition to a satellite state has been a relatively simple process. The security of this state remains contingent upon adequate Soviet military and police support. Under these conditions diversity of policy or expressed opinion in the Soviet Zone is not to be expected. German resistance will remain ineffective. The US, on the other hand, does not have sole control of western Germany, which it shares not only with the UK and France, but to a considerable extent with the Germans, who have been given wide authority in many matters.

Clashes between US policy and that of the UK and France are frequent, while the Germans repeatedly display a strong tendency not to cooperate either among themselves or with the occupying powers.

In the western zones, where the democratic principle allows for a wide divergence of views, constructive efforts are subject to disagreement among the Allies, potential resistance by the German government, strikes and demonstrations on the part of discontented German workers, and lack of a definite plan or decision with regard to the ultimate place of Germany in the community of nations. After considerable delay and difficulty, a constitution for a west German state was formulated in line with the London decisions of June 1948. Although not completely satisfactory either to the Germans or to the Western Allies and highly offensive to the USSR, the new west German government organized in September 1949 may be expected to achieve a greater degree of stability and progress than has hitherto been possible under the conditions of the Occupation. Nevertheless, friction between the new federal government and the High Commission over differences of interpretation of the Occupation Statute and the Basic Law is inevitable and will cause German dissatisfaction with occupation policies. This will benefit Communist and nationalist elements at the expense of political leaders who favor cooperation with the Western Powers.

Given time, the US may succeed through the North Atlantic Treaty, the OEEC, and other agencies in building up a degree of political and economic stability in Western Europe which would make it increasingly impolitic for the USSR to contemplate using military force to achieve its ultimate objectives. In such a program Germany holds potentially a key position, which it may ultimately realize in a developing system of European cooperation or union. There is danger, however, that already existing anti-democratic and nationalist tendencies will be strengthened. As it is, the Germans feel no particular responsibility for the second World War, and their attitude toward the occupation is one of tolerance rather than of cooperation.

S E C R E T**V-3**

Against generous US economic assistance are set such policies considered harmful to long-term German interests as the Ruhr decisions, the restrictions on trade and industry, and the program of dismantlings. Such policies have fostered German suspicions, exploited by Soviet propaganda, that the UK and France intend to eliminate Germany completely as a future competitor for world markets. Even the 31 March 1949 Allied agreement on prohibited and restricted industries, by denying exemption to such key industries as synthetic fuel and rubber, has failed to overcome Ger-

man suspicion on this controversial point. These views dampen enthusiasm for western doctrines and encourage revival of nationalistic hopes. A progressive weakening of US support would spell disaster, and another inflationary cycle in western Germany would undo much of the good accomplished since currency reform. So far, the western Germans have shown no desire to welcome Communism as a way of life. This would not, however, deter them from reaching a rapprochement with the USSR if such a course appeared to be expedient.

S E C R E T

SECRET**ENCLOSURE A****DISSENT OF THE INTELLIGENCE ORGANIZATION, DEPARTMENT OF STATE**

OIR dissents because, although SR-20 appears to be accurate in the details covered, the report does not present an adequate picture of the situation in present day Germany. The report is not focused on and does not adequately discuss certain decisive political problems and tendencies in Germany today.

The following factors, among others, are not at all or not adequately discussed: The basic differences in the political, social, and economic structure of East and West Germany (for example: semi-socialist system and trend toward "People's Democracy" on the one side, free enterprise and parliamentary democracy on the other); the political effects of the fundamental social, and economic changes in East Germany (for example: na-

tionalization, agrarian reform, elimination of the old ruling groups); the political position and policy of the West German Government (for example: social basis, stability, proposed legislation, bargaining position toward Western Powers); the relationships between the major political parties (for example: socialist opposition; left-wing tendencies in the CDU); the political role of business (for example: the political aspiration of the Ruhr industries, employers' associations and their influence); the tendencies toward East-West cooperation and integration (for example: the pro-Eastern potential in Western Germany, function of new nationalism). OIR believes in consequence that the text does not convey a sound understanding of the situation in Germany.

SECRET

SECRET**ENCLOSURE B****DISSENT OF THE INTELLIGENCE ORGANIZATION, DEPARTMENT OF STATE****Chapter II and Summary***

The organization for Research and Intelligence in the Department of State dissents from SR-20 (Chapter 2 and Summary) because it considers the report an inadequate picture of the present German economic situation even though the data given in the report appear generally accurate.

Many important current issues such as the Ruhr problem, foreign trade prospects, trade between western and eastern Germany, fiscal and financial policies, investment needs, the effects of ERP on the German economy, are either omitted entirely or discussed inadequately. The two year plan for the Soviet Zone as well as a number of other important issues are mentioned in the summary but not developed in the body of the report.

Although the report purports to be up-to-date as of September 1, 1949, many facts and figures lag behind that date. For example,

the application beginning in May 1949, of the exchange rate DM 1=\$0.30 to imports of foodstuffs, and the resulting problem of food subsidies is omitted. Other important events, such as the devaluation of the mark and the new decisions on dismantling have been omitted because they occurred after September 1. These events are of such far-reaching importance that an adequate picture of the German economy cannot be given unless the deadline is extended to include them.

In relation to matters that the report does include, focus and emphasis are often distorted, in that the relative space given to various subjects is frequently out of proportion with their relative importance.

The conclusion is that SR-20 (Chapter 2 and Summary) does not enable the reader to obtain a reasonable and adequate impression of the present economic state of Germany.

* Chapter II and the Summary were issued after the publication of the remainder of the report and were therefore reviewed separately by the IAC agencies.

SECRET

APPENDIX A

TERRAIN AND CLIMATE

1. Terrain and Drainage.

The terrain of Germany is of two major types. The northern part of the country is a broad, undulating lowland that extends from the North Sea eastward into Poland and the USSR. Most of it is below 300 feet in elevation and almost all is under 600 feet. The southern two-thirds of Germany is an upland area with varied relief that rises to 5,000 feet in places. The uplands consist of a complex arrangement of mountain blocks and intervening depressions. In the extreme south, Germany includes some of the northern ranges of the Alps. The highest peak is the Zugspitze (9,720 feet).

The major rivers of Germany flow northward to the North Sea or the Baltic Sea. The only exception is the Danube, which flows eastward to the Black Sea. In spite of its length (560 miles from its source to Passau on the Austrian frontier), the Danube is not as important for navigation as are the other large German rivers. Transportation on the Danube is limited mainly to small barges.

The river systems crossing the northern plain, named from west to east, are the Rhine, the Ems, the Weser, the Elbe, and the Oder. The Rhine is the most important waterway of Europe and the great unifying feature of western Germany. With its three great tributaries—the Main, the Neckar, and the Moselle—it drains a large area. Between Basel and Lauterbourg, the Rhine forms the frontier between France and Germany; from Basel to Bingen it flows northward through the rift valley between the Vosges Mountains and the Black Forest (Schwarzwald); from Bingen to Bonn it cuts across the highlands in a deep gorge; and below Bonn the river enters the North German Plain. The mouth of the

Rhine, however, is in the Netherlands. The meanders of the Rhine below Bonn were straightened out and the entire river was regularized in the 19th century both to protect the cultivated lands and to improve navigation.

Of the north-flowing rivers, only the Oder River drains into the Baltic Sea. It is the principal waterway of eastern Germany. The Weser, Ems, and Elbe flow into the North Sea. Neither the Ems nor the Weser is comparable as a traffic artery with the Elbe, which is navigable for barges as far upstream as Aussig in Bohemia. Levees and embankments are necessary along the lower courses of all four rivers to minimize the effect of floods. Egress to the sea can be insured only by constant dredging of the shallow tidal estuaries, by the maintenance of dykes, channels or ship canals, and by the construction of breakwaters to prevent longshore drifting from blocking the deepwater harbors.

a. The North German Plain.

The North German Plain, despite its low relief, contains a variety of land forms and types of economic development. In the west, it includes the Lower Rhine Plain, and the Münster and Cologne (Köln) lowlands, which extend like bays into the Rhine Highlands. The Münster Bay is an area of low relief and fertile soils that make it one of the most productive agricultural sections of Germany. Cologne Bay, though less productive, is well above the German average. The nearly flat Lower Rhine Plain merges imperceptibly into the Rhine Delta of the Netherlands. It is noted particularly for its dairy industries.

Within the western section of the North German Plain are some of the most important industrial regions of Germany. The Ruhr coal fields, by far the most important in Germany, lie along the northern margin of the

Middle Rhine Highlands, and the industrial Ruhr Region extends northward onto the plains and supports a practically continuous urban belt from the Rhine River eastward through Essen to Dortmund. Important but smaller industrial areas surround Cologne and Aachen.

Along the North Sea, the coast from Emden to the Danish border is low and sandy, and is protected from the open sea by the Frisian Islands that lie parallel to the coast and are separated from it by stretches of tidal mud and sand. The Ems, Weser, and Elbe flow through broad, shallow estuaries to reach the North Sea. Hamburg and Bremen, the most important two ports of Germany, are located up the estuaries respectively of the Elbe and Weser, far from the sea.

The Baltic coast, east of the Danish peninsula, is not protected by a chain of offshore islands. The river mouths, especially along the east Baltic coast, are exposed to longshore currents, and sand bars have formed landlocked, fresh water harbors or *Haffa*. South of, and roughly parallel to the Baltic coast from Denmark through East Prussia is a zone of low sand and gravel hills intermixed with small lakes. Inland from this zone is a belt of lower land that was once the valley of a large river system that flowed westward to the North Sea. Today, the western end of this valley is occupied by the Elbe River, whereas farther east the drainage has been diverted northward to the Baltic Sea.

South of the old valley is a second zone of hills with poorly drained depressions that extends southeast from the North Sea to Silesia and Poland. The western end of this zone is heath that occupies much of the land between the Ems and Weser rivers. East of the Elbe, the areas of heath or moor are somewhat smaller and are separated by valleys.

On the south, the North German Plain merges into the Foreland of the German Highlands. The Foreland is an area of better drainage, fertile soils, and mineral deposits, which make it one of the most productive and densely populated parts of Germany. Hannover, Magdeburg, and Breslau are all located along the northern margin of the Foreland near extensive deposits of brown coal and salt.

b. The German Highlands.

South of the Foreland are the German Highlands. This complex area consists of a number of diverse features—basins, valleys, plateaus, and mountains—which may be classified according to location into three general groups: (1) the Western Uplands; (2) the Central and Eastern Basins and Uplands; and (3) a Middle Area that rises gradually from north to south.

(1) The Western Uplands.

The northernmost of the western upland areas is the Middle Rhine Highland. This is divided into eastern and western plateau areas by the Rhine River, which from Bingen to Bonn flows through the narrow Rhine Gorge. The plateau to the west of the river is bleak, moor-covered, and sparsely populated. The plateau is separated from the forest-covered area to the south by the Moselle River, which flows from the French border to Koblenz on the Rhine. The Palatinate Hills farther south are more dissected and merge into the Saar Basin in the west. This basin, famous for its coal deposits and industrial development, is also an area of forested hills and cultivated valleys.

East of the river, the Middle Rhine Highlands begin immediately to the south of the Ruhr Industrial Region. Along the northern fringes of the highlands and in the valleys are areas of considerable industrial importance and medium-sized cities such as Solingen, Remscheid, and Siegen. The eastern uplands are less bleak than the plateau west of the Rhine. The highest elevations and steepest slopes occur in the northwest.

The eastern highlands are interrupted on the south by the lower Main Valley, which includes the important city of Frankfurt, and by the Neckar, which joins the Rhine at Mannheim. Both the Main and the Neckar valleys lead to the Middle Rhine Plain, a broad lowland area of fertile soils and wide river terraces that are intensively cultivated. In the past, its main significance has been agricultural and commercial, but with the development of Ludwigshafen and Mannheim, the Rhine Valley has also become important industrially.

South of the Main is the Odenwald and south of the Neckar the higher and more scenic Schwarzwald. The highlands continue southward to the Swiss border.

(2) *The Central and Eastern Basins and Uplands.*

The Eastern Uplands include the Sudeten Mountains, the Ore Mountains (Erzgebirge), and the Bohemian Forest, which together form a rim of highlands around the Bohemian Basin of Czechoslovakia. To the north, the Erzgebirge open into Saxon Uplands. The valleys of these mountains and uplands were industrialized at an early date because of local ore deposits. Today Chemnitz is the heart of the modern industrial activity.

Between the Erzgebirge and Sudeten mountains is the Elbe Gorge, which forms the gateway from Germany to the Bohemian Basin. Dresden controls the entrance to this gateway. The Sudeten Mountains are heavily wooded and sparsely populated but along the northern foothills is an area of fertile soil, high crop yields, and denser population. The Bohemian Forest, the mountains along the western border of Czechoslovakia, is continued to the northwest as the Thuringian Forest. Apart from their timber supply and attractions for summer resorting, these forested mountain areas are of little economic importance.

North of the Thuringian Forest is the Thuringian Basin which is drained by the Saale River. It is an area of specialized industries and crafts that had their origin in the Middle Ages. Salt deposits in the north and lignite in the west are the basis of the modern industry of the area. Although the rougher lands in the basin are wooded, much of the area is in pasture or under cultivation. Within the basin is an east-west string of small cities of cultural and industrial significance. Among these are Eisenach, Gotha, Erfurt, and Weimar.

The isolated block of the Harz Mountains lies to the north of the Thuringian Basin and is completely surrounded by lowlands. The main lines of communication in Central Germany circle the mountains. Only a few minor routes cut across this barrier.

(3) *The Middle Area.*

Midway between the two areas of diverse highlands is a broad area of low relief that slopes upwards to the Jura Uplands in the south, continues to the Alpine Foreland, and finally reaches the high elevations of the Alps. The northernmost section is essentially the basin of the upper Weser River and its tributaries. The landscape is varied and includes forested mountains, mountain meadows, and broad river valleys with prosperous farms.

Separated from the northern area by old volcanic mountains is a depression that includes the upper basins of the Main and Neckar rivers. Here the relief is varied and includes ridges, broad valleys, and low escarpments. Nürnberg, the most important city of the depression, is favorably located at a break in one of the escarpments that affords an easy route between the Main and Danube valleys. Stuttgart, which ranks second to Nürnberg in importance, is also a center of modern industry. The depression, however, is primarily an area of small homesteads, fields, pastures, apple orchards, and pine forests.

To the south, the depression ends abruptly at the Jura Uplands, a series of north-facing, limestone escarpments that stand out like walls. The forested escarpments reach elevations of 1,200 feet in the north and many of them are the sites of ancient castles. The Jura Uplands dip gently to the south toward the Danube River. The soils of much of the upland have been stripped of their forest cover, are of inferior quality, and support only a scattered population, except in the river valleys.

Beyond the Danube River, the Alpine Foreland rises gradually to the base of the Bavarian Alps. The northern part of the foreland is hilly and fertile. Elongated lakes are found in the central part of the upland, and extensive moors in the higher lands to the south. The Iller, Lech, Isar, and Inn rivers, which rise in the Alps, flow through broad and, in many cases, swampy valleys. Munich, the capital of Bavaria, is a transportation center located at a point where East-West routes cross the Isar River.

Rising above the foreland on the south are the true Alps, high limestone ridges that are snow-covered most of the year. Picturesque villages, Alpine lakes, and mountains combine to make the area particularly attractive to tourists. Valleys cut deeply into the mountains and provide routes of communication with the Inn Valley and from there to Italy via the Brenner Pass.

2. Climate.

The climate of Germany is transitional between marine and continental. In western and northern Germany the climate is moderated somewhat by nearness to the Atlantic Ocean and North Sea. To the east, summer and winter temperatures become progressively more extreme and rainfall lower. Germany also lies in the path of eastward-moving storm fronts, which bring rapid changes in temperature and heavy rains. The influence of the storms is more pronounced in the west than in the east.

January mean temperatures average 32° F or lower in eastern Germany and in the higher elevations to the south, and 32° F or higher in the west and northwest. When winds, associated with the advance of a polar front, blow from the east or northeast, minimum temperatures below 0° F may be experienced. July means vary from 57° F to 67° F, being higher in the east and south than in the west and northwest. The number of days with frost varies from lows of under 60 in the Rhine Gorge area and 60 to 80 in western and northwestern Germany to over 120 in the mountain areas in the south. Most of southern Germany (where elevations of 1,000 to 3,000 feet prevail) and east central Germany have 100 to 120 days of frost. Consequently, the growing season is longest in the west and northwest and shortest in the south and east.

Freezing temperatures produce ice conditions less frequently on western than on eastern rivers. For example, the Rhine has an average of 15 days with ice at Mainz and 13 at Köln, whereas the Elbe has 30 days at Magdeburg and the Oder has 43 days at Frankfurt-an-der-Oder. Coastal navigation on the North Sea is seldom hampered by ice for more than one or two days a year, although severe cold

spells may cause sea ice that lasts for a week or more. The Kaiser Wilhelm Canal is affected for ten days a year on the average. Navigation on the Baltic coast may be stopped for continuous periods from one to two months.

Precipitation in the plains of north Germany varies from 20 to 30 inches, with the higher precipitation in the west. In the highest mountain areas to the south, however, the rainfall averages over 60 inches a year. Rainfall is usually adequate at all seasons. A slight maximum occurs in mid-summer, and is more pronounced in the east than in the west. In general, the amount of precipitation varies little from year to year, the average departure from normal being about 12 percent for Berlin. The number of days on which snow falls varies from less than 30 in the west and northwest to over 50 in the extreme east and the high mountains of the south.

The cloudiest season is winter, and December is the cloudiest month everywhere, except on the highest mountains. In December, about 8/10 of the sky is covered on an average. Even in the summer months, cloudiness averages about 6/10. Fog occurs most frequently along the North Sea coast, with an average of about 50 foggy days per year. Fogginess is more prevalent in mid-winter in the north, and in the fall in the rest of Germany. In industrial towns, where the air is contaminated by smoke and fumes, as in the Ruhr region, the fogs are heaviest. Throughout Germany visibility is highest in summer, when it may be expected to exceed six miles on more than half the days. Visibility is lowest during January, February, and March.

In Germany, winds blow most frequently from the southwest and least frequently from the southeast. Wind intensity is greater near the coast than inland. The windiest season is winter along the coast, and early spring farther inland. Summer is a season of light winds, and September has the highest percentage of calm. Weather unfavorable for flying is most frequent in the winter but even then flying is possible more than half the time. At air terminals the unfavorable weather conditions most likely to interrupt

S E C R E T**A-5**

○ flying are visibility of less than 2½ miles and ceilings lower than 1,000 feet. Between terminals, unfavorable weather conditions likely to interfere with air traffic are storm fronts, layers of dense clouds, and severe icing and turbulence at flight levels.

Winter also has the least favorable weather for ground transportation. In January and

February the average road traffic for the whole country decreases by approximately 15 to 20 percent.

Although the German climate is not especially pleasant, it is conducive to human health and efficiency. Current studies place the climate of Germany in the highest "human efficiency" category.

S E C R E T

APPENDIX B

SIGNIFICANT COMMUNICATIONS FACILITIES

1. Harbors.

Before the war Germany had 25 ports which handled over 100,000,000 tons of shipping annually. The largest of these, and one of the largest in Europe, was Hamburg, which accounted for approximately 40 percent of German shipping activities in 1937. Bremen was Germany's second port, although the volume of ocean traffic passing through it was only about a third of Hamburg's. These two ports and their subsidiaries dealt with all the long-distance passenger trade and most of the deep-sea cargo vessels. The Baltic ports had a much more restricted type of traffic concerned primarily with short-sea cargo vessels trading to the Baltic countries and with a limited passenger service represented mainly by train-ferry service to Denmark and Sweden. Coastwise traffic, by both tramp and liner, was well-developed in prewar Germany, serving the ports of each coast and forming a connection between the two through the Kiel Canal. The coastwise trade in 1937 constituted about one quarter of all shipping entries.

The trade of Bremen and Hamburg was distributed over a great range of commodities and countries. Bremen's position west of Hamburg gave it a slight advantage in being closer to the Ruhr industrial district and more convenient to trans-Atlantic passenger traffic. Bremen imported more cotton, nearly as much wool, and a great deal more iron ore, and it exported much more coal. Bremen was not only the largest cotton-importing port in Germany but through its well-organized cotton exchange it supplied the textile industries of a number of central European countries. Essentially a railway port, Bremen's tonnage of railway freight was not far below that of Hamburg.* Both Bremen and Hamburg were

* Seagoing traffic at Hamburg during 1948 was 7.9 million tons or only 37 percent of the 1936 figure of 21.4 million tons.

important industrial centers, with extensive shipbuilding facilities, drydocks, and related industries, all of which were almost totally destroyed by bombing during the war. The port facilities were completely wrecked not only from Allied air attacks but from German scorched-earth tactics in rendering the ports useless for Allied invasion operations.

When US forces took control of the ports in the Bremen Enclave in April 1945, the basins were filled with wreckage; docks and warehouses had been destroyed, and railways and canals were inoperable. In addition, the harbor basins and the Weser estuary had been mined extensively by the Germans. All navigational lights and other aids to navigation had been destroyed by the German Navy just prior to the entry of the Allied forces, and dredging during the war had been sadly neglected. Moreover, the organizations which had conducted and controlled engineering and maintenance work in the rivers and ports, and operated water transportation with all its correlated activities, had disappeared.

The Bremen Civil Port Authority, a German organization, was reconstituted and charged with the actual operation of ports and waterways in the Enclave under US control. By September 1945 the area had been cleared of mines, and navy salvage groups began the work of removing sunken vessels and other obstacles to navigation. Although Bremen was finally opened to ships of small tonnage on 11 September 1945, the tonnage of cargo discharged did not reach any proportions until January 1946, when UNRRA shipments to Czechoslovakia were diverted to that port. By April 1946 the canal system connecting Bremen with southern Germany had been repaired to such an extent that water traffic was again possible between the Enclave and the US Zone.

In 1945 the Allies designated Bremen and Bremerhaven as ports for the US Zone and set up Bremen and the surrounding area as the "Bremen Enclave" under US occupation and MG policy. In December 1945 the area was placed under British MG policy while retaining US occupation and MG personnel. In January 1947 the Enclave reverted to US control and was created as the fourth *Land* of the US Zone. In order to keep occupation costs at as low a figure as possible and to prevent the drain of US currency from JEIA funds to pay transportation charges from non-German areas, shipping for the bizonal occupation forces and for the general economy of western Germany have passed through the ports of Bremen or Hamburg.

Both the Dutch and Belgian governments have objected to this diversion of US-UK trade exclusively to German ports, arguing that shorter ocean routes to Rotterdam and Antwerp, and natural barge routes from these ports to western and southern Germany via the Rhine and the canal system, mean cheaper shipping costs as compared with the more northerly German ports. Rail connections are also shorter, and these natural advantages in the past caused a good proportion of German traffic to flow through Low Country ports despite the attractive rail rates and heavy port subsidies offered by the Reich. An informal understanding was reached by all governments concerned to route a certain proportion of German imports and exports through Low Country ports. Nothing came of it, however, because of MG objections to the accumulation of debts in Germany in favor of other nations, as these obligations might become an additional liability of the Occupying Governments, which are already bearing the major share of occupation costs. After further negotiation, however, the Low Country Port Agreement was signed at Frankfurt 24 September 1948 and put into effect in November. It permits German IWT and coaster craft to enter Benelux ports and waterways, foreign craft to utilize the German IWT system, and establishes a Central Booking Office in Rotterdam to quote rates for the Rhine shipment of Bizonal imports.

2. Inland Waterways.

Germany has led in the development of inland waterways, the physical geography of the country facilitating this development. The Rhine is unequalled among European rivers in facilities for an enormous carrying trade, and it provides the heavy industries of the Ruhr with the great advantage of very low transportation costs for ore and coal. In the North German Plain, the Elbe and the Oder follow courses which favor the movement of cargoes toward the chief centers of industry and population. A number of large canals link the great rivers to form a comprehensive network. The total length of canals and rivers which can be used for inland navigation is 8,000 miles, of which 4,600 miles are of major importance, including 1,500 miles of canals. Most of the principal waterways admit barges with a carrying capacity of 1,000 tons, and the whole network carried 133 million tons of cargo in 1937, which was 27 percent of the freight moved by German railways that year.

During the war a considerable proportion of civilian goods was shifted from rail to water to clear the railroads for military purposes, and water-borne tonnage increased to 30 percent. This was made possible by the excellent canal system linking all parts of Germany with the North and Baltic Seas, and by the opening in 1938 of the Rothensee ship-lift on the great Mittelland Canal, which provided the necessary link for large barges between the Rhine, the Ruhr, Berlin, and the Oder. The state took control of inland waterways in 1921, and in 1935 the Reichs Transport Group for Inland Shipping (R.V.B.) was organized to advise the Government and to represent all shippers and enterprises concerned with inland navigation. So well organized was the system by 1939 that Germany's war purposes were far better served than had been the case in 1914.

As a result of the war, the channels were blocked with the debris of fallen bridges and sunken tugboats and barges. The canals, in addition, sustained extensive damage to locks and banks, which impeded their restoration to a greater extent than the physical obstacles in their channels. As a result, the main

waterways were closed until the spring of 1946 and their traffic capacity reduced to 25 percent of normal for the next three years. About 75 percent of inland waterways are now open to traffic but on many the restrictions are such that the volume of traffic is far below the prewar level. It is unlikely that prewar traffic potential and efficiency on inland waterways will be regained before 1955.

Inland navigation affords an important means of relief to the over-taxed German railway system. As much freight as possible has been diverted to German waterways, which carried 31 percent of the total tonnage in 1946 compared to 27 percent before the war, although the volume of this tonnage was only 20 percent of what it was under normal conditions. Terrific handicaps had to be overcome in the replacement, repair, and upkeep of the inland waterway fleet of tugs and barges, which severely taxed the facilities of the badly damaged shipyards. Of the prewar tugs and barges about three-fourths remained, and 60 percent of these had to be raised and repaired before being put back into service. The tonnage in operation declined in 1947 because the production of materials was insufficient to keep pace with current repair requirements. Many of the vessels, apart from war damage, were over-age; and increase in the total fleet on a scale to meet future traffic requirements called for larger amounts of material than could be made available for this purpose. Despite these drawbacks, a total of 48,720,000 M.T. was loaded and discharged on bizonal waterways in 1948, a 41 percent increase over 1947, although far short of the 62.6 million tons carried in 1938.

3. Railways.

The outstanding feature of Germany's transportation system, in peace as in war, was its dependence on railroads. The country was rich in coal and iron, but lacking in rubber and oil. The distribution of German natural resources depended on rail and water movement rather than air and motor transport. In the course of a century, Germany had developed an extensive railway and canal network, which was constructed not only for peacetime needs but for the requirements of

war. Although the Third Reich undertook the motorization of Germany by constructing an elaborate system of superhighways and airfields, its main reliance continued to be placed on railroads and canals. Occupying a central position in the European continent, German rail lines connected with the systems of eight other countries, a connection which favored both the operation of through train services and the movement of trade across the frontiers. By 1939 Germany was adequately prepared for a land war based on internal lines of communication. Despite later developments in aviation, and the use that could be made of conquered resources, Germany was unable to employ air transportation to the fullest extent, except in emergencies.

The present railway system is substantially the same one as that of 1914, totaling about 35,000 miles of tracks. As a consequence of that war, Germany lost about 4,000 miles of railway, and since then comparatively little new building has been undertaken. Only four hundred miles of track was laid in twenty years and most of this duplicated existing sections. The main emphasis, apart from improved train operation and design resulting in increased speeds, shifted from construction to policy and was marked by the gradual disappearance of state and private railways, and the emergence of the centralized Reichsbahn. Under the Dawes Plan of 1924 a new national railway system was organized as an autonomous entity called the Deutsche Reichsbahn-Gesellschaft, the purpose being to mortgage the railway network in order to secure its earnings for the partial payment of reparations. This scheme came to an end in 1932, but the autonomous character of the organization was continued and more lines were absorbed into the national system until 1937, when the Nazis achieved the final absorption of the railways. Less than six percent of the lines then remained independent of the Reichsbahn, which was highly organized and scientifically operated for the purpose of developing the state both economically and strategically. The head of this organization, a Cabinet Minister, controlled all means of transportation in the Reich. The railways employed 839,000 persons in 1939 and were

financially sound, operating costs being lower than elsewhere in Europe, with the traffic fairly heavy and well distributed.

At the time of the capitulation, transport in Germany was at a complete standstill, and the Allies were faced with a tremendous recovery program. Wrecked rolling stock and equipment, bombed or blown out bridges and track, blocked 90 percent of the railway lines in the Combined Zones. Over 2,600 bridges, large and small, had been blown up, all the Rhine crossings as well as those of the Weser and Elbe were down, as were all crossings in the Ruhr area. Few yards were workable and most of them were filled with bombed or burnt-out rolling stock. Workshops and engine sheds were badly damaged, in some cases totally destroyed. No record is available of the destruction of locomotives and rolling stock, which have been most difficult, if not impossible to replace. It is estimated that 59 percent of the steam locomotives, 41 percent of the electric locomotives, 37 percent of the passenger cars, and 38 percent of the goods wagons were lost or completely put out of service as a result of war action. Neighboring countries have also seized or retained rolling stock in good condition. The number of serviceable goods wagons in the Combined Zones declined from 232,000 in May 1946 to 179,000 in May 1947. This situation improved slowly in 1948 until there were 247,854 freight cars and 8,206 locomotives available for service by December, a number considered adequate for the immediate demands upon the Transportation System.

The main contribution of the Bizone has been the restoration of facilities for international transit traffic, both passenger and freight, thus permitting the movement of such important commodities as coal from Germany into Poland, Belgium, and other war-ravaged areas. Within a year of the surrender, 97 percent of the 13,000 kilometers of main-line track in the US Zone was again in operation, and 90 percent of the rail bridges had been repaired. By dint of overcrowding, more passengers were being moved than before the war, and the average length of haul per passenger is about twice what it was in 1936. Freight haulage in the US Zone has recovered

to only 73 percent of normal, and little further improvement may be expected until there are more locomotives, cars, and a greater efficiency of coal consumption. The Germans allowed normal replacement standards to lapse during the war, and a large amount of the serviceable stock was over-age and in poor condition because of the lack of necessary repair materials; consequently the railroads use an unnecessarily large amount of coal, at the expense of industrial consumption.

Despite the fact that the railways were given priority in obtaining materials needed for their rehabilitation, German industry has functioned at such a low level that it was difficult to procure the necessary supplies. The amount of the machine tools supplied to the repair shops have been inadequate so far, and essential raw materials like rubber, leather, and asbestos have been difficult to procure. Nearby countries like Belgium and Czechoslovakia possess ample facilities for both the manufacture and repair of rolling stocks, but Germany lacked the requisite foreign exchange to obtain such equipment abroad until ECA provided funds to build 17,000 freight cars outside Germany and 3,000 in the Bizone by 1 January 1949. It is estimated that 5,000 new locomotives and 200,000 new goods wagons are required before German railways can operate at a level sufficient to maintain the over-all economy, and this does not allow for the replacement of rails, switchpoints, and signal equipment which have deteriorated to the point where train movements are hazardous. Financially the position of the Reichsbahn is unsound, because currency reform increased operating costs, and decreased volume of passenger traffic. Inadequate rates caused an operating deficit of 160,000 D.M. by the end of 1948. During the first quarter of 1949 operating revenue continued to decline and no funds were available for major repair and reconstruction. Railway personnel is recruited largely from the prewar Reichsbahn, except for the officials who were dismissed under denazification laws.

Today there are 42,330 kilometers of serviceable first-line track in operation in all Germany, of which 58 percent is located in the bizonal area, 30 percent in the Soviet Zone,

and 12 percent in the French Zone. Serviceable equipment is distributed among the zones in about the same proportion, although dismantlings in the Soviet Zone, particularly the removal of track and rolling stock for shipment to Russia, have seriously crippled transport facilities in eastern Germany. In 1946 approximately 188 million tons of freight and nearly 2 billion passengers were carried on German railroads. Freight traffic in 1948 increased to 276.5 million tons and passenger traffic to 3 billion passengers. Railroads in the 3 Western Zones carried about 70 percent of the freight and 45 percent of the passengers. Restrictions imposed on rail shipments between Berlin and the Western Zones after 1 April 1948 by the USSR greatly reduced the volume of traffic, which ceased altogether on 24 June 1948 when the USSR instituted a blockade of the city. Following the counterblockade imposed by the Western Allies on 24 July 1948, all rail traffic between the Soviet Zone and the Western Zones was suspended until 12 May 1949 when the blockade was lifted and normal intercourse resumed. Restoration of all transport facilities in all four zones has been very slow, particularly with regard to locomotives and rolling stock, because of material shortages.

4. Roads.

German roads were slow to assume importance in the national economy. They had a haphazard local development and were not designed for long-distance traffic. The best main roads were generally equal to the highest European standards, but on the average, German roads compared unfavorably with those of France and England, being fewer in number per unit of population and having narrower, poorer surfaces. During the winter months, snow, ice, and fog reduced the movement of road traffic as much as 20 percent.

German roads deteriorated badly during the first World War and continued to deteriorate for some years thereafter despite sporadic efforts to improve them sufficiently to accommodate an increasing volume of motor traffic. Not until the advent of the Nazis did road construction become an important phase of government policy, of which the auto-

bahnen scheme was the outstanding aspect. This was the most imposing engineering project undertaken by the Nazis, calling for 4,500 miles of super-highway, of which about 65 percent had been completed by 1939. The autobahnen system comprised a grid consisting of six principal highways, two running across the country from north to south, three from east to west, and one from the northwest to the southeast (Hamburg to Breslau via Berlin). The new highways began and ended at strategic points on the frontiers and served directly all the important industrial areas and regional administrative centers. Cities and other built-up areas were detoured so that high-speed long-distance traffic might avoid congested streets. About 91 percent of all autobahnen surfacing consisted of concrete. Numerous bridges were built to carry the autobahnen over railways, secondary roads, canals, rivers, and other obstructions to through traffic.

National road administration was unified for the first time in 1934 with the creation of a supreme department of road construction and maintenance. All state and municipal rights in road building or planning were abolished, and complete authority was given to an Inspector-General of Roads in the Ministry of Transport. Although the number of motor vehicles in Germany tripled in the years between 1934 and 1938, this still represented only 1 vehicle to every 44 persons, compared with 1 to 19 in Great Britain and France.* Despite Nazi efforts to motorize the country, German motor transport, when war came, was still in its initial stages and carried only about 3 percent of the freight carried annually by the railways.

In the closing stages of World War II retreating German armies carried out road demolitions designed to hinder the Allied advance. At the commencement of the occupation the highways were in a chaotic condition, and many of the routes were impassable as a result of blown-out bridges. Highway transport was old, war damaged, and completely

* 64,422 motor vehicles were produced in the Bizone in 1948 (29,942 passenger cars, 27,951 trucks, 5,662 tractors, rest miscellaneous). This was about 55 percent of 1936 production.

B-6

SECRET

disorganized. Only 60 percent of the vehicles had escaped destruction and could be put back into service. Other transport agencies were in worse shape, however, and until the railroads and inland waterways could be brought back into operation, a disproportionate burden had to be borne by road vehicles. Once this was accomplished, it was decided to confine commercial highway traffic to short-haul freight and passenger service that could not be carried by water or rail, a restriction made necessary by Germany's inability to pay for large imports of gasoline, lubricants, rubber tires, and spare parts. Moreover, the supply of road-making materials, especially asphalt, has been so short that only one-third of even the military road network could be maintained. By July 1947 some 15 percent of the damaged highway bridges had been permanently repaired and 68 percent had been temporarily put into service pending replacement by permanent structures. All but a very small mileage of the total highway system was open to traffic by January 1949, although only 25 percent of it was in good repair. Although systematic reconstruction of the highway network was delayed to some extent by financial stringency in 1948, labor and materials were available in sufficient quantities, and considerable progress was made in restoring the road system to its normal traffic capacity. Lack of funds for long-term capital investment is the principal obstacle in the way of further rehabilitation of the entire German transport complex.

5. Telecommunications.

Prior to the war Germany maintained one of the most complete communications systems in the world. All postal, telephone, and telegraph services were provided by a governmental agency known as the *Reichspost*, which functioned as a department of national government headed by a Cabinet Minister. In addition to providing an extensive postal banking system, the *Reichspost* operated the largest commercial motorbus system in Germany, consisting of more than 5,000 lines. Since the occupation, *Reichspost* participation in commercial transportation has been sharply reduced. The *Reichspost* was also

active in radio services, operating all public broadcast transmission facilities, engaging actively in research and development, and acting as the licensing agency for other radio services. This phase of communications has been removed from *Reichspost* control and placed under *Land* broadcasting corporations established by the *Laenderrat*. *Reichspost* participation in this field is limited to the provision of wire and cable facilities, and the collection of radio receiver fees. These steps were taken in conformance with MG policy for general economic decentralization where practicable.

During the war the efficiency and grade of *Reichspost* services deteriorated rapidly as trained personnel was drafted into the army and equipment suffered heavy damage from Allied bombings. Conditions were such that the cessation of all services was ordered on VE-Day. Rehabilitation was at once undertaken, however, and by the end of 1945 all important services had been restored within the US Zone. Since the economic merger of the US-UK Zones on 1 January 1947, all *Reichspost* services rendered prior to the occupation have been re-instituted within the bizonal area. Major postal and telecommunications services have also been re-established interzonally with the French and Soviet Zones and the City of Berlin. By May 1947 more than 70 percent of the telephones and approximately 98 percent of the prewar telephone central offices had been restored to service in the US Zone. Rehabilitation of long-distance cable facilities has progressed as rapidly as materials have become available, but are still inadequate for current requirements. All long-distance communications facilities were transferred to the *Reichspost* on 1 October 1947, including those employed by the occupational forces, and full responsibility for the provision of bizonal telecommunications services was assumed by German bizonal agencies.

International telecommunications involve a variety of complications, mostly of a financial nature, and it was not until January 1947 that quadripartite approval in principle was reached on the re-establishment of these services. Through special arrangements, both international telephone and telegraph services

SECRET

SECRET**B-7**

were established in the US-UK Zones on 1 April 1947, and are now available to the US and all countries in the Western Hemisphere as well as to all Western European nations with the exception of Spain and Portugal. There are no restrictions on incoming calls or messages, but only those German residents of the US-UK Zones who are engaged in business activities beneficial to the economic recovery of Germany are licensed by JEIA to initiate international traffic payable in Reichsmarks. The consummation of business deals or contracts is not permitted, however, nor is the discussion of Germany's external assets allowed.

In most respects, the Deutsche Post shares the difficulties and shortages common to the whole of the bizonal economy. By far the greatest shortage at present is textiles, required principally for the manufacture of telephone instrument and switchboard cords. Procurement of other essential material has improved partially as a result of ERP aid. As construction materials and labor became increasingly available during the last quarter of 1948 the program of permanent reconstruction of communication facilities made substantial progress. The vast extent of war damage, as well as the cumulative normal depreciation of the war years, remains a limiting factor, however, and by the beginning of 1949 communications plant facilities—both building space and technical equipment—were still much more limited than those in use before the war. At the same time, domestic telegraph, telephone, and postal service volume were three times greater than prewar volumes. Personnel efficiency is much greater since currency reform, and service quality has therefore shown improvement more rapidly than the rate reflected merely by rehabilita-

tion of equipment. Although there were 7 percent fewer telephones in 1948 than in 1937, domestic long distance telephone traffic originating in the three western zones was 162 percent of the 1937 volume, and quarterly revenues for 1948 were 43 percent above quarterly revenues for 1938.

6. Civil Aviation.

Civil aviation in Germany, which lacks as yet a unified national status and which functions under zonal control of four foreign occupying powers, has necessarily followed a pattern of development prescribed by these powers. The Potsdam Agreement provides only that Germany's war potential should be eliminated and made no specific reference to civil air activity. Prescription of an over-all civil air pattern to apply uniformly to the four occupied zones, however, has been thwarted by cleavage among the occupying powers, leading to partition, and consequent unbalanced development of civil aviation in Germany.

The Western Powers have consistently supported adoption of a policy designed to open German air space to controlled world air commerce and to develop civil aviation in Germany within the limits imposed by the Potsdam Agreement; the USSR, equally consistently, has blocked all efforts toward four-power agreement on either count, unilaterally construing the Potsdam Agreement as precluding any phase of national civil air activity. Inevitably, the schism between Western and Eastern ideology has led to zonal partition of German civil air endeavors to conform to the opposing ideals, producing unbalance in the development of civil aviation in Germany as a whole.

SECRET

APPENDIX C

POPULATION STATISTICS AND CHARACTERISTICS

As a result of the war there have been violent dislocations of the total population and profound disruption in the conditions of living and employment in postwar Germany. Total defeat, with its terrific war casualties, amounting to 4 million killed and approximately 1.5 million still held outside Germany as prisoners of war (January 1949), shattered the former social fabric and crippled every phase of the national economy. Despite these losses and the continued retention by the USSR of a large number of prisoners, the population has actually increased with the acquisition of roughly 10 million refugees, including 2 to 3 million "Volksdeutsche" from neighboring countries. On a land area 24 percent smaller than in 1936, Germany is supporting 20 percent more people. Every war has produced its homeless refugees, but never before in modern history has there been such an extensive organized transfer of population as that provided for in Article XIII of the Potsdam Agreement. Acute shortages in many of the essentials of living and correspondingly limited opportunities for employment, the assimilation of refugees and expellees into the German community are among the more formidable problems facing the German people today.

The German population grew rapidly in the prewar years, practically doubling between the establishment of the Empire in 1871 and the outbreak of World War II. After the advent

of the Nazis, with their program of special incentives to propagation and their policy of annexing contiguous territories containing a high percentage of German inhabitants, the increase was even more spectacular. In the old Reich the increase was 4 percent between 1933 and 1939, while the population of Greater Germany, so-called, which included Austria, the Sudetenland, and the Saar, had grown 20 percent. The density of population was determined by the distribution of natural resources, the heaviest concentrations of inhabitants occurring along the southern and eastern borders: in the Ruhr, along the Rhine, and in Silesia. A population belt of lesser density stretched along the northern coast, with its large ports surrounded by agricultural areas reclaimed from the sea over a long period of time by dykes and drainage canals, as in Holland. The central plain of Germany, which has few resources and a poor soil, had a relatively sparse population, except for the big industrial cities.

The industrialization of Germany caused an immense growth of its cities and towns. Urban population quadrupled while the population as a whole was doubling in numbers, and 65 percent of the people were living in cities by 1939. The movement from farm to industry was accelerated during the Nazi regime, which saw a 10.6 percent occupational decline in agriculture and an 8.6 percent growth in industrial employment. The great-

DENSITY OF POPULATION IN FOUR ZONES

	Area in sq. km.	Population 1946	Persons per sq. km.	
			1939	1946
British Zone	97,714	22,303,042	203	228
French Zone	42,814	5,939,807	145	139
Soviet Zone	107,805	17,313,581	141	161
Soviet Zone Including Berlin	108,689	20,493,964	180	189
United States Zone	107,461	17,174,367	133	160
TOTAL	356,678	65,911,180	168	185

SECRET

C-1

SECRET

est occupational change in this period was a 34.2 percent increase in the number of public servants, who constituted the enormous bureaucracy essential to the functioning of authoritarian government in preparation for total war. After the war, however, the trend to the cities was sharply reversed. Urban population declined 14 percent and rural areas gained 29 percent as war damage and hunger forced people to abandon their wrecked homes in search of food, shelter, and employment in the country. A considerable part of this postwar gain in rural population derives from the occupation policy of settling refugees and expellees on farms, where they contribute little to agricultural productivity and are merely a burden upon the farmer.

In line with postwar developments, the population of the city of Berlin has decreased 26.4 percent. In Germany, as a whole, the only one of the four occupation areas to show a decrease has been the French Zone, the population having fallen off 4.3 percent, which may be accounted for in part by the transfer of a great many Germans to the Saar to work in the coal mines. On the other hand, the US Zone has shown the greatest percentage of increase with 20.5, the Soviet Zone is next with 13.7, and the UK Zone third with 12.7. One of the most significant features of the present situation is the great disproportion between males and females in all four zones and in Berlin. In all of Germany there are 8 million more women than men, with the most extreme disproportion occurring in the Soviet Zone, where women are 76 percent more numerous than men. This situation arises in part from the Soviet policy of deporting great numbers of German workers to Russia and in part from Soviet retention of German prisoners of war. The disproportion for all of Germany is 24 percent. If all the prisoners of war outside Germany were returned, it would do much to restore a normal economic potential to the country and a more normal pattern to family and community life.

The population problem for Germany would appear to be that of a largely industrialized people living in a much smaller area than formerly but in greater numbers, a disproportionate number of females, and several million

new people difficult to assimilate. Greatly decreased industrialization and the impossibility of adding appreciably to the farm population make it very difficult to find gainful employment or to produce food enough to support everybody. This in turn is relevant to another serious condition in Germany—the great decrease in the number of able-bodied persons capable of earning their own living and of contributing to the economy of the country. While in the long run it may be possible to absorb the expellees and redress the imbalance of the sexes, the lack of material facilities needed to maintain the population will require more outside assistance than any so far undertaken for the revival of the German economy.

The population of Germany is more mixed racially than that of any other country in central Europe and probably on the whole continent. This is not surprising in view of Germany's extent and central position and the geographically ill-defined nature of the national frontiers, as well as of the fact that it was settled by a number of tribes and has been the scene of various migrations. The racial or ethnic character of the German people results chiefly from an age-long intermixture of Nordic and Alpine stocks, with the former prevailing in the northern and western areas, and the latter in the southern region along the Rhine and the Danube. East of the Oder, definitely Slav types appear, broad-faced and broad-headed. In central Germany there is a very mixed population. Racial differentiations at best are blurred or obscure, and the sharpest divergence among peoples in various parts of Germany occurs in the matter of dialect. Phonetic differences are most apparent between northern and southern areas, with the speech of the former retaining the old Saxon characteristics (Low German), while the latter underwent considerable modification into High German. Each area in turn contains a number of dialects which differ markedly from each other. These differences have been much reduced in recent years by mass culture media,* while

* Pronunciation, for example, was standardized in 1898 by Theodor Siebs, whose treatise on the subject was widely used in the schools, on the stage, by radio announcers, etc.

SECRET

SECRET

C-3

the ethnic problem was clarified, officially anyhow, by the Nazis, who imposed upon their countrymen the myth of a single superior Teutonic race, undefiled by alien mixtures of any sort.

In the hands of the Nazis the theory of creed of the Master race became an important political weapon. A class-conscious society servilely obedient to the voice of authority facilitated the ready acceptance of this doctrine at home. The effect on German youth was particularly deplorable, and it shaped to a considerable extent Nazi policy both at home and abroad. Some of the consequences were the anti-Semitic laws depriving German Jews of their rights and resulting ultimately in their practical extinction, sterilization of the unfit, "mercy killings" of the aged and infirm, special incentives to Aryan youths to propagate *ad libitum*, and a profound hostility to the Christian religion.

In 1933 there were 40 million Evangelical Protestants in the old Reich, 21 million Catholics, and about 500,000 Jews. In 1946 there were 40 million Protestants, 24 million Catholics, and a negligible number of Jews, probably less than 50,000. While there is no clear-cut geographical distribution of the three main religious creeds—Roman Catholic, Lutheran, and Calvinist—the provinces of the north German plain from Schleswig-Holstein to East Prussia have very large Protestant majorities, although Oldenburg and Hesse have substantial Catholic minorities. Both to the west and east of the northern plain—in the Rhineland and in Westphalia as in Silesia—there are Catholic majorities; while in the south, Bavaria is overwhelmingly Catholic, Baden somewhat less so, and Wuerttemberg is Protestant. The development of Protestantism in Germany since the Reformation has very largely been under secular control, first of the territorial Princes, then of the *Laender*, and after 1871 of the Reich as well. Under the Weimar Republic the *Laender* continued to maintain important rights of supervision over the Evangelical churches, especially over the administration of their finances, and to give the aid of civil power in the collection of church

taxes.* The Roman Catholic Church, on the other hand, successfully resisted secular interference with its affairs despite the efforts of Bismarck to force upon German Catholics the same cultural uniformity to which all other Germans had to submit. Under Wilhelm II, as well as under the Weimar Republic, the Catholic Church was left alone and grew in prosperity and numbers. The political influence of the Center (Catholic) Party and of the Christian trade unions also continued to grow. The rise of the Social-Democratic Party after 1871, with its definitely anti-religious propaganda, alienated many of the working class from both churches. Only the Catholic Church was able to retain a hold over the industrial masses in certain strongly Catholic districts like the Ruhr and Upper Silesia through Christian trade unions and social and religious organizations.

The Nazi religious program aimed at the creation of a single German National Church on a strictly racial-nationalist basis. The figure of Christ was to be retained but in the guise of an heroic Nordic leader, done to death by the Jews and misinterpreted by another Jew, St. Paul. The historic close connection between church and state facilitated Nazi control of the Evangelical churches, which were quickly converted into instruments of the Nazi ideology despite the resistance of many Protestant pastors, mostly of the "Confessional" wing.** The Catholic Church proved more awkward to handle, but unremitting pressure, both political and economic, as well as campaigns of intimidation and violence, greatly circumscribed Catholic activities. By suppressing all religious youth organizations, absorbing all German children into the Hitler Jugend, and substituting "undenominational" for confessional schools, the Nazis undertook to lay the foundation of their German National Church. The outbreak of the war intensified the persecution of both Protestants and Catholics, and the concentration camps were filled with people who chose to remain loyal to their religious beliefs.

* 256 million marks were collected by state taxation for all Churches in 1937.

** Organized in 1934 by Martin Niemöller to oppose Nazi attempts to unify the GEC by means of false doctrine, force, etc.

SECRET

APPENDIX D

SIGNIFICANT BIOGRAPHICAL DATA

ADENAUER, KONRAD

Konrad Adenauer. Age 73. The first Chancellor of the new German Federal Republic, Adenauer's political power is rooted in his position as chairman of the Christian Democratic Union (CDU) in the British Zone, which makes him in effect the leader of the largest party in western Germany. Adenauer's Catholic, bureaucratic background, and his administrative career under the Weimar Republic explain his strong conservative tendencies. Although a strong proponent of a federated Germany within a future federated Europe, Adenauer has become increasingly critical of certain policies of the western occupation powers, and notably that of dismantling. As can be expected, he is strongly anti-Marxist, and opposed to any nationalization of industry, for which reason he has been adamantly against political partnership with the Social Democratic Party (SPD). Despite his western orientation, Adenauer will, in relations between western Germany and the Soviet Zone, avoid any policy which in his estimation would imperil the ultimate reunification of Germany.

ARNOLD, KARL

Karl Arnold. Age 48. Minister-President of North Rhine-Westphalia, the largest *Land* in west Germany, and President of the west German *Bundesrat*, Arnold is the leader of the left wing of the Christian Democratic Union (CDU) and is, next to Adenauer, the most prominent figure in that party. Before 1933, Arnold was a functionary in the German Christian labor unions, and since 1945 has represented a much more progressive social and economic stand than that officially adopted by his party. Arnold would not be adverse to political coalition with the Social Democratic Party (SPD), nor to a modified socialization program. He is a proponent of

European federation and of German cooperation with the west, but is also a staunch defender of German national interests, as his campaign against the west German border rectifications early in 1949 testifies. Arnold is regarded by the supporters of the federalistic principle as the chief centralist within the CDU.

EISLER, GERHART

Gerhart Eisler. Age 52. Active in Communist Party movement since 1919 and, together with Ulbricht, probably one of the more influential German Communists in eastern Germany today. His Communist activity has been spread over a number of European countries including Austria, Denmark, Czechoslovakia, Spain, and France. In Spain he fought with the Loyalists in the International Brigade. Offered a haven from a French concentration camp in the United States, Eisler soon became one of the key Communist agents in the Western Hemisphere. In 1947 Eisler was indicted and convicted in the US for passport fraud and contempt of Congress. After his escape from the United States on the Polish liner "Batory" in May 1949 and his subsequent release by a British extradition court, Eisler was welcomed in the Soviet Zone of Germany, where he immediately joined the SED, and assumed his duties as a member of the People's Council. Shortly afterwards he was appointed chief of the Information Division of the Soviet Zone Central Administration. As a Communist of long standing who has withstood the acid test of Western capitalistic influence, Eisler enjoys the complete confidence of the Soviet Communist Party and is often photographed with such top Soviet officials in Germany as Ambassador Semenov.

He and Walter Ulbricht (q.v.) are the most influential theoreticians of the Marxist-Leninist school in eastern Germany today.

FISCHER, KURT

Kurt Fischer. Age 49. Fischer, one of the old-line Moscow-trained German Communists, has since July 1948 been the chief of the German Administration of the Interior (GAI) of the Soviet Zone. He is at present one of the key men in the Soviet control mechanism, in a position which is rapidly becoming the most powerful in the entire Soviet Zone. Fischer is a fanatical and ruthless Communist who has rendered yeoman service to the SMA in his present position, and also earlier as Minister of the Interior in *Land* Saxony. Although Fischer's relations with the Socialist Unity Party (SED) hierarchy have on occasion been cool, there is no doubt as to his unswerving loyalty to the USSR.

GROTEWOHL, OTTO

Otto Grotewohl. Age 54. Co-chairman of the Socialist Unity Party. Grotewohl was expelled from the Social Democratic Party in April 1946 because of his activities with the SED. Now Prime Minister of the new German Democratic Republic, he has consistently followed the Moscow line. He has been in the Social Democratic movement since 1910, represented the SPD in the *Reichstag*, and held the post of Minister of Interior and Justice in the Brunswick Government for several years. He remained in Germany and was arrested a number of times between 1933-1945. In 1945 he became chairman of the SPD central committee and then led the SPD in the National Front movement of the left wing parties in Berlin. Upon the formation of the Communist-sponsored Peoples Council, Grotewohl was elected to its presidium. Since the war he has made several trips to Moscow and has visited Belgrade, Budapest, Prague, and Warsaw. He is said to have received Soviet citizenship and the rank of major in the Red Army.

HEUSS, THEODOR

Theodor Heuss. Age 65. Heuss was elected first President of the German Federal Republic on 12 September 1949. Prior to becoming Federal President, he was Chairman of the Free Democratic Party (FDP) in western Germany. A liberal journalist by profession, Heuss was also a *Reichstag* deputy for seven years prior to 1933, and has served as a *Landtag* delegate in Wuerttemberg-Baden since

1946. Heuss considers his primary function as Federal President to be that of an arbiter between the various conflicting elements in the *Bundestag*. He inclines toward the left wing of the FDP and opposes both unrestrained nationalism and extreme federalism. Heuss is strongly anti-Communist and anti-Soviet, and wholeheartedly in favor of Germany's equal participation in a United States of Europe.

KOEHLER, ERICH

Erich Koehler. Age 57. Elected president of the *Bundestag* (Lower House) of the German Federal Republic. As president of the Bizonal Economic Council, he showed himself to be an excellent mediator and administrator, although his political perception and understanding of social and economic issues have been questioned. While he devoted most of his time to business activities until 1945, he had been active as a member of the National Executive of the German People's Party until 1933. As member of the Hesse Constituent Assembly and chairman of the administrative council of the Hesse Provincial Central Bank Koehler won the respect of all with whom he came into contact. His ability to mediate and arbitrate frequently has served as a buffer between his own party, the CDU, and the SPD, as well as between Military Government and the Germans.

OLLENHAUER, ERICH

Erich Ollenhauer. Age 48. Ollenhauer is Vice-Chairman of the Social Democratic Party (SPD) in west Germany and unofficial leader of the SPD minority in the new *Bundestag*. Active ever since 1920 in the SPD, Ollenhauer is considered one of the most astute and well-balanced machine politicians in Germany today, although he lacks the outstanding oratorical abilities of his party chief, Dr. Schumacher. Ollenhauer, a "right-wing" Social Democrat, enjoys Schumacher's full confidence and is expected to assume the chairmanship of the SPD whenever Schumacher is no longer able to continue in that post.

PIECK, WILHELM

Wilhelm Pieck. Age 73. As co-chairman of the Socialist Unity Party (SED) he is the "grand old man" of German Communism. Born in Guben, Brandenburg, and apprenticed

SECRET

D-3

as a wood-worker, Pieck has been active in union and Marxist circles since the start of the century. He was one of the original members of the German Communist Party founded by Rosa Luxemburg and Karl Liebknecht. Prominent in all the social turmoil of the twenties, Pieck was forced to leave Germany for the USSR in 1933. A member of the executive of the Comintern, he was one of the founders of the Free Germany Committee (NKFD) in 1943 and has been influential in its subsequent development. He consistently follows the Moscow party line. Because of his prestige as leader of the SED, Pieck is one of the best known political figures in Germany today. Although recently he has appeared to be developing into a figurehead for younger elements of the party because of his age and poor health, he is reported to be even now a restraining influence on the more violent party members. Pieck also retains his value as a symbol for German Communism and as such will continue to be exploited by the Soviets.

RAU, HEINRICH

Heinrich Rau. Age 50. Chairman of the German Economic Commission (DWK) of the Soviet Zone, Rau has been an active Communist ever since the founding of the Spartacus League in 1919. After Hitler's advent to power, he was for several years an agricultural economist in Moscow, and fought later with the First International Brigade in the Spanish Civil War. Rau, as a completely dependable tool of Moscow, has the full support of Walter Ulbricht in his present position, despite the reported desire of certain "nationalist" SED circles to bring about his downfall. Rau is one of the ablest and most successful Communist economic administrators, and is largely responsible for the development of the current Two-Year Plan for the expansion of the Soviet Zone economy. Holding the highest administrative position in the Soviet Zone, Rau would probably be one of the key figures in any separate East German State.

SCHMID, KARL

Karl Schmid. Age 53. Vice-President of the *Bundestag*, former Deputy State-President and Minister of Justice of Wuerttemberg-Hohenzollern, and Chairman of the Social Democratic Party (SPD) in that *Land*, Schmid

is the only outstanding politician from the French Zone on the west German scene today. With his legal and academic background, he was highly influential in shaping the Bonn Constitution, and is almost certain to prove the most prominent SPD speaker in the new *Bundestag*. Schmid's advocacy of European federation and of cordial Franco-German cooperation is understandable in view of his own French and German descent. Although he was the German Military Administrator of Lille, France, during World War II, Schmid was not subject to reproach for any actions of his during this time, but actually won praise for his Francophile attitude. Despite repeated rumors of his being a French tool and at odds with the SPD leadership, his independence and his good standing within his own party do not appear open to question.

SCHUMACHER, KURT

Kurt Schumacher. Age 54. Chairman of the Central Committee of the Social Democratic Party (SPD) and one of the most influential politicians in Germany, Schumacher has made of his party the most firmly anti-Communist and anti-Soviet political unit in Germany today.

Of a bourgeois academic background, he advocates a socialistic national state including the territory east of the Oder. An extraordinarily able speaker despite infirmities from World War I and his ten years in a concentration camp, Schumacher, although opposed by many leaders of his party, has practical and undisputed control of the western SPD, as well as a strong influence on surviving SPD elements in Soviet-controlled territory. Although critical of certain US-UK Zone domestic policies, he has cooperated in opposing Communist infiltration and in supporting the Marshall Plan. The main bone of contention between Schumacher and the SMA is over the readmittance of an independent SPD in the Soviet Zone. Although Schumacher's physical condition has long been poor, it has not caused him to relax his control over the party and his political activity may well continue for a long time to come.

ULBRICHT, WALTER

Walter Ulbricht. Age 56. As leader of the Moscow-trained wing of the Socialist Unity

SECRET

Party (SED) and trusted agent of the Kremlin, Ulbricht is the most powerful German figure in the Soviet Zone of Germany. Originally a Leipzig wood-worker, he has been an active Communist since 1919. Before 1933, Ulbricht was a member of the Central Executive Committee of the German Communist Party and Secretary of the Berlin District organization. Later he was one of the Communist "brain trust" in Madrid during the Spanish Civil War. He helped form the Free

Germany Committee in July 1943 and later returned to Germany with the Red Army. Active in various Soviet-inspired organizations, Ulbricht concerns himself with practically every aspect of administration in the Soviet Zone. His principal contribution to Soviet Zone politics has been: (1) ardent sponsorship of the merger to form the SED; (2) the Antifa Bloc Policy; and (3) energetic support of Soviet policies directed at creation of a police state in the Soviet Zone.

SECRET

APPENDIX E

CHRONOLOGY

- 1870 Franco-Prussian War: Napoleon III surrenders at Sedan (September 2) and France yields Alsace-Lorraine and large indemnity in peace treaty.
- 1871 German Empire established, the constitution coming into effect 1 January and King William of Prussia crowned Emperor at Versailles on 18 January.
- 1890 Resignation of Bismarck as Chancellor (18 March); Wilhelm II takes over direction of German foreign and domestic policy.
- 1900-14 Growing tension between the Triple Alliance and the Entente over trade, armaments, colonies, etc.; Germany gives Austria free hand in the Balkans (1908), thus angering Russia and reversing Bismarck policy of friendly relations on the East.
- 1914 Assassination of Archduke Francis Ferdinand by Servian nationalists at Serajevo (28 June); Austrian ultimatum to Serbia (23 July) followed by Russian mobilization; Germany invades France via Belgium (3 August) bringing Great Britain into war; German army stopped at the Marne (9 September).
- 1917 Germany declares unrestricted submarine warfare (31 January); US breaks off diplomatic relations with Germany (3 February) and declares war (6 April).
- 1918 Treaty of Brest-Litovsk (3 March), Russia withdraws from war and German troops occupy Ukraine. Allies break German western front (8 August); Ludendorff asks for armistice (29 September); revolution breaks out in Germany (29 October); the Kaiser abdicates, a Republic proclaimed with Ebert as Chancellor; Allied armistice terms accepted (11 November).
- 1919 Treaty of Versailles (22 June) disarms Germany, deprives it of 27,275 square miles of territory, and imposes heavy but unspecified reparations. Election of National Assembly (19 January); adoption of Weimar constitution (31 July) providing republican form of government. Communist uprisings in Berlin, Bavaria, and elsewhere crushed by the Free Corps.
- 1919-24 Period of rampant inflation as Germany seeks to evade payment of reparations, French occupy the Ruhr (January 1923); nationalist reaction grows, republican leaders assassinated by young reactionaries; attempted Munich beer hall putsch (8 November 1923) of Bavarian nationalists under Adolf Hitler dispersed by the Reichswehr.
- 1925-29 Period of relative economic stability; Dawes and Young Plans regulate reparations question; large loans from US employed to revive German prosperity; Germany joins League of Nations, and Stresemann as Chancellor wins political concessions from Allies but not enough to satisfy Hitler-Hugenberg nationalists who flourish on denunciation of Treaty of Versailles.
- 1930-32 Period of severe economic depression: emergence of Nazis as strongest party in Reichstag as hard times swell nationalist ranks; failure of unconstitutional efforts of Hindenburg to solve problems by appointment of "non-political" authoritarian cabinets.
- 1933 President von Hindenburg forced to appoint Hitler as Chancellor (30 January); Reichstag fire (28 February) inaugurates Nazi reign of terror; Reichstag "En-

SECRET

E-1

- abling Act" (23 March) confers supreme power on Cabinet (Hitler); decree-law (14 July) suppresses all political parties except the National-Socialist. Goering organizes the Gestapo to enforce compliance with Nazi regime.
- 1934 Trade unions abolished and replaced by German Labor Front under Nazi control (20 January). Blood purge (30 June) of von Roehm, Schleicher, and other dissidents within the Nazi regime, thus consolidating personal power of Hitler.
- 1936 Rhineland reoccupied and remilitarized (March). German military units support Franco rebellion in Spain. German-Italian Pact establishes Rome-Berlin Axis (25 October). Anti-Comintern Pact signed with Japan (26 November). Italy adheres (6 November 1937).
- 1938 Annexation of Austria (11-12 March). Munich Pact (30 September) gives French and British acquiescence to Hitler's acquisition of the Sudetenland from Czechoslovakia.
- 1939 German troops occupy rest of Czechoslovakia, which becomes a German protectorate (14-15 March). Rome-Berlin Axis consolidated when Italy and Germany sign 10-year military pact (22 May). Germany and Russia sign 10-year mutual non-aggression pact (24 August). German army invades Poland (1 September); England and France declare war (3 September).
- 1940 End of *Sitzkrieg* or "cold war" when German army invades Norway (8 April); Germans overrun Belgium and the Netherlands (10 May) and invade France; Paris occupied (15 June) and armistice signed by France (22 June). Italy joins Germany in the war (10 June).
- 1941 Germany invades Russia (22 June) without declaration of war. Following Japanese attack on Pearl Harbor (7 December), Germany declares war on US (11 December).
- 1942 German armies invade North Africa but fail to drive the British out of Egypt. US-UK invasion of North Africa (7 November) under command of General Dwight D. Eisenhower.
- 1943 German army surrenders at Stalingrad (2 February); beginning of German retreat from Russia. Surrender of German North African forces in Tunis (12 May). Allies invade Sicily (11 July) and mainland of Italy (3 September). Italy signs armistice with Allies (8 September) and declares war on Germany (13 October).
- 1944 Allied invasion of Normandy (D-Day, 6 June); liberation of Paris (23 August); attempted assassination of Hitler at army headquarters (19 July); US forces reach German soil (23 September); Russians take Warsaw (2 October); Battle of the Bulge (17-27 December), last German counter-offensive of the war.
- 1945 Big Three Conference at Yalta (3-11 February) decrees unconditional surrender for Germany and punishment of Nazi war criminals; Allied forces breach Siegfried Line defenses (14 February); US Military Government setup at Frankfurt-am-Main (30 March); Russian troops reach Berlin (26 April); suicide of Adolf Hitler and his mistress (30 April); German military forces surrender unconditionally to the Allies (6 May); Potsdam Conference (17 July - 2 August) outlines terms for Germany, reducing it to 3rd rate power incapable of making war. Germany divided into 4 zones of occupation with joint occupation of Berlin, and Allied Control Council set up in Berlin to coordinate administrative functions and carry out occupation objectives.
- 1946 Level of Industry Plan (March) disarms Germany industrially by setting post-war limits to economic recovery. First free municipal elections since 1933 held (26 May) in 38 cities in US Zone, won by CDU. Berlin municipal elections (20 October) won by SPD, Communists getting less than 20 percent of vote.

SECRET

E-3

- 1947 Nuremberg War Crimes Trial verdict (1 October) against 22 Nazi leaders; Goering and 11 associates sentenced to death, Schacht and von Papen acquitted.
Failure of Council of Foreign Ministers at Moscow (March) and at London (December) to agree on German peace treaty. US and UK Zones combined economically (1 January).
- 1948
January Serious food shortages in western Germany cause widespread protest strikes and demonstrations and decline in industrial production. Ruhr declared an emergency area and placed on special rations. Meeting of London Conference on German affairs.
- February Reorganization and strengthening of Bizonal Economic Council (6 February).
March German central administrations in Soviet Zone subordinated to reorganized and expanded German Economic Commission (DWK) to be strongly centralized agency staffed by SED under SMA control.
Meeting of Soviet-sponsored People's Congress in Berlin to agitate for German unity on Communist terms (18 March).
Breakup of Allied Control Council in Berlin, end of quadripartite government for Germany (20 March).
- April USSR imposes restrictions on rail traffic to Berlin after US-UK reject Soviet unilateral inspection of freight (1 April).
Soviet restrictions extended to barge traffic (20 April).
- May Soviet Half Year Plan adopted to raise production 10 percent in Zone in last six months 1948; Two Year Economic Plan being worked out. Shrinkage of East-West trade causing concern to SMA. Poor food situation in western Germany occasions new outbreak of protest strikes and demonstrations.
- June London Agreement on provisional western German government (1 June).
Currency reform in western Germany (18 June).
USSR suspends all passenger traffic between western and eastern zones (19 June).
Western currency reform extended to Berlin (22 June).
New Soviet currency introduced in Berlin (23 June).
USSR suspends all passenger and freight traffic into Berlin because of technical difficulties (24 June).
US-UK airlift started (26 June).
- July Breakup of Allied Kommandatura, and of quadripartite control of Berlin (1 July).
Imposition of the Western Power counter-blockade cutting off all interzonal trade with the Soviet Zone (24 July).
- August-
September Moscow-Berlin talks. Reference of the Berlin dispute to the United Nations.
September Meeting of Parliamentary Council of western German states at Bonn to draft constitution for a provisional western German government (3 September).
Communist-inspired mob forces Berlin city assembly to vacate city hall in Soviet sector (7 September). Split in city administration continually widened by dismissal of officials on political grounds by both eastern and western sector administrations.
- November Tightening of credit restrictions by Bizonal banks in order to check dangerous inflationary tendencies and curb rising prices that are endangering the wage structure.
Final split of Berlin municipal government after Communist "rump" assembly

SECRET

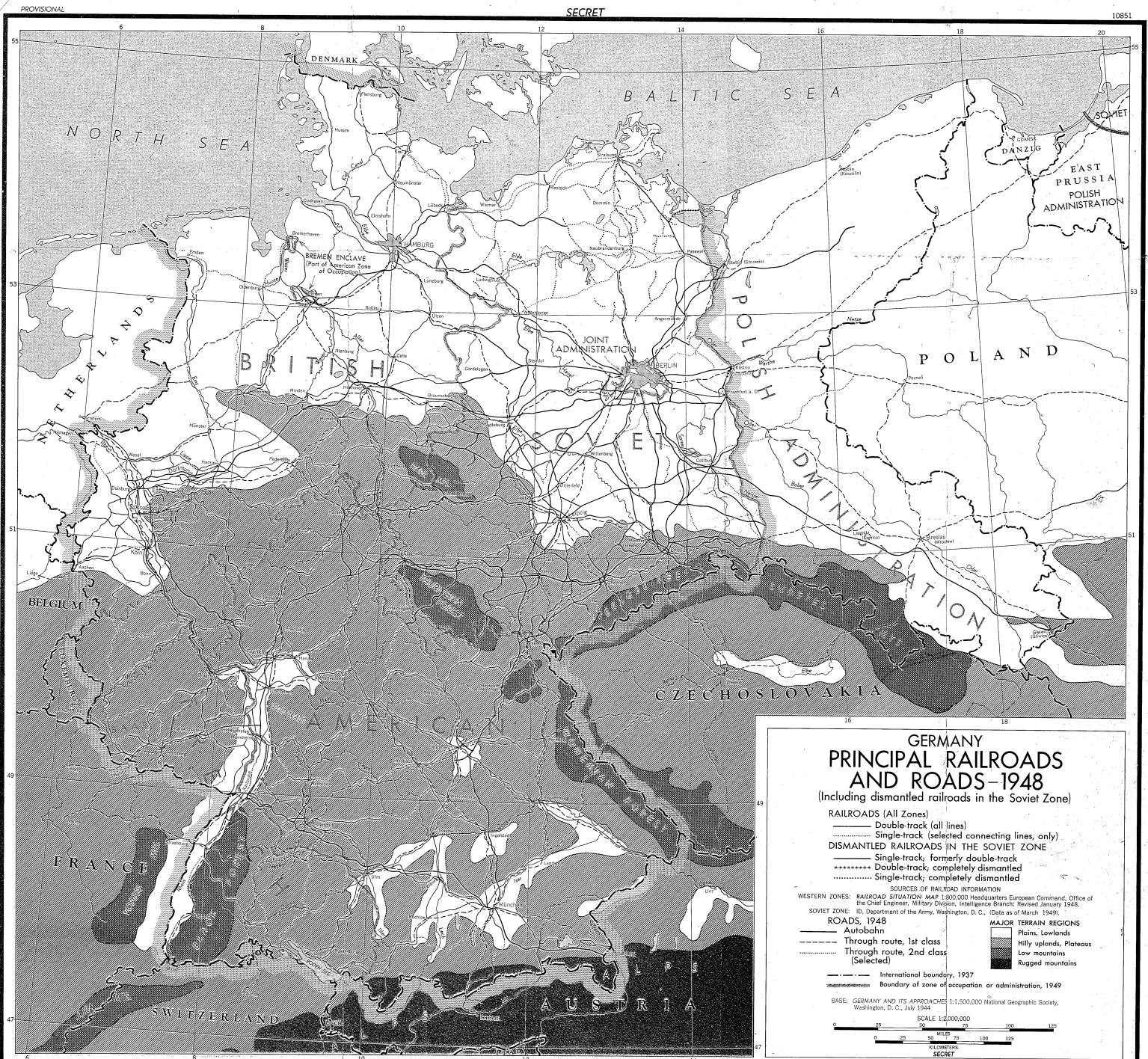
E-4

SECRET

- sets up "legal" government for eastern sector of city and Friedrich Ebert is appointed Oberbuergermeister by the SMA (30 November).
- December** Western sector elections for Berlin Magistrat with SPD obtaining 65 percent of the vote. Elections not permitted in eastern sector (5 December).
First reading of the draft constitution (basic law) completed by the Bonn Parliamentary Council (10 December).
Six-power agreement reached at London establishing an International Authority of the Ruhr to supervise German coal and steel production. Hostile reaction in Germany to the loss of this vital area (28 December).
- 1949**
- January** First session of new western sector Berlin Magistrat with Communists not present. Election of Ernst Reuter as Lord Mayor and Otto Suhr as chairman of the assembly, both SPD (19 January).
Second reading of the draft basic law at Bonn. Text contains many major points of disagreement but door left open for further interparty negotiations (19 January).
SED political party convention held in east sector of Berlin emphasizes German unity theme and foreshadows reactivation of Antifa bloc of "democratic" parties (purged of reactionary elements) as a possible basis for a future east German State (25 January).
- February** Main Committee of Bonn Parliamentary Council finishes third and final reading of basic law, large areas of disagreement still remain (10 February).
Committee of Neutral Experts appointed by President Juan Bramuglia of UN Security Council to consider solution of Berlin currency problem concludes sessions after adopting a non-committal report (11 February), following US dissent from earlier conclusions and Soviet rejection of US counter-proposals.
- March** The three western Military Governors present a delegation from the Bonn Parliamentary Council with a memorandum outlining the objections of the Occupying Powers to deviations from the London decisions in the draft of the basic law, principally those regarding finance powers, police, and centralized federal authority (2 March). Five-man inter-party committee appointed to reshape draft constitution according to "suggestions" in memorandum.
Committee of Neutral Experts notifies UN Security Council that it has failed to work out an independent solution of the Berlin currency dispute (16 March). The Committee was appointed 30 November 1948 in response to the US note of 29 September 1948 requesting UN consideration of the critical Berlin situation created by unilateral Soviet actions.
Soviet Zone People's Council (Volksrat) approves draft constitution for "all Germany", subject to plebiscite to be held in May (18-19 March). Western Zone German leaders invited to discuss unity question with Soviet Zone Germans at Brunswick on (8 April) but invitation is rejected.
SPD party conference rejects Bonn basic law draft because of its extreme federalistic character (20 March).
Currency change-over in western sectors of Berlin makes D-mark sole legal currency and outlaws Soviet Zone east mark except for limited uses over a restricted period of time (20 March).
Military Governors state that German counter-proposals of 16 March to Military Governors' Memorandum of 2 March are unsatisfactory (25 March). Stalemate at Bonn continues.
Agreement on Prohibited and Restricted Industries signed at London (31 March) provides for removal of certain key industries such as synthetic fuel and rubber

SECRET

- April** and limits production in such categories as steel, ball bearings, aluminum, etc. Western Allied Foreign Ministers Conference at Washington reaches agreement on German questions (8 April).
Text of Occupation Statute proclaimed by Military Governors (10 April).
Conference of Military Governors and Bonn Parliamentary Council delegates reach compromise agreement on basic law (25 April).
Tass (USSR) News Agency despatch reveals Jessup-Malik negotiations regarding Berlin dispute and possible Soviet lifting of blockade (25 April).
Representatives of three Western Powers and Benelux countries sign the agreement establishing the International Authority of the Ruhr (28 April).
- May** Official four-power announcement of lifting of Berlin blockade on 12 May and holding of CFM on 23 May (5 May).
Bonn Parliamentary Council gives final approval to the basic law by a vote of 53-12. In the Soviet Zone results of zonal elections for the Volkskongress indicate considerable popular dissatisfaction with the Communist regime. Berlin railroad workers start strike against Soviet-controlled Reichsbahn Administration.
- June** Strike of Berlin railroad workers ends (28 June), as western commandants oblige the union to accept settlement proposed by the Reichsbahn. The Paris CFM ends (20 June) with little progress toward agreement on German problems.
- August** In national west German elections the conservative and right-wing parties win a substantial majority in the Bundestag, and interparty squabbles begin. The economy of the western sectors of Berlin reaches an alarming point of deterioration.
- September** The Bundesversammlung meets in Bonn (7 September) to deliberate on choice of a Federal president. Theodor Heuss, chairman of the Free Democratic Party, is elected Federal President (12 September) and the nomination of Konrad Adenauer, leader of the CDU, as Federal Chancellor, is approved by the Bundestag (15 September). Adenauer announces his cabinet (20 September), and Federal government officially comes into existence.



PROVISIONAL SECRET 10851

GERMANY PRINCIPAL RAILROADS AND ROADS—1948

(Including dismantled railroads in the Soviet Zone)

RAILROADS (All Zones)

- Double-track (all lines)
- - - Single-track (selected connecting lines, only)

DISMANTLED RAILROADS IN THE SOVIET ZONE

- - - Single-track; formerly double-track
- Double-track; completely dismantled
- Single-track; completely dismantled

ROADS, 1948

- Autobahn
- Through route, 1st class
- - - Through route, 2nd class (Selected)
- International boundary, 1937
- - - Boundary of zone of occupation or administration, 1949

MAJOR TERRAIN REGIONS

- Plains, Lowlands
- Hilly uplands, Plateaus
- Low mountains
- Rugged mountains

SOURCES OF RAILROAD INFORMATION

WESTERN ZONES: RAILROAD SITUATION MAP 1:500,000 Headquarters European Command, Office of the Chief Engineer, Military Division, Intelligence Branch; Revised January 1948.

SOVIET ZONE: ID, Department of the Army, Washington, D. C., (Data as of March 1949).

BASE: GERMANY AND ITS APPROACHES: 1:1,500,000 National Geographic Society, Washington, D. C., July 1944.

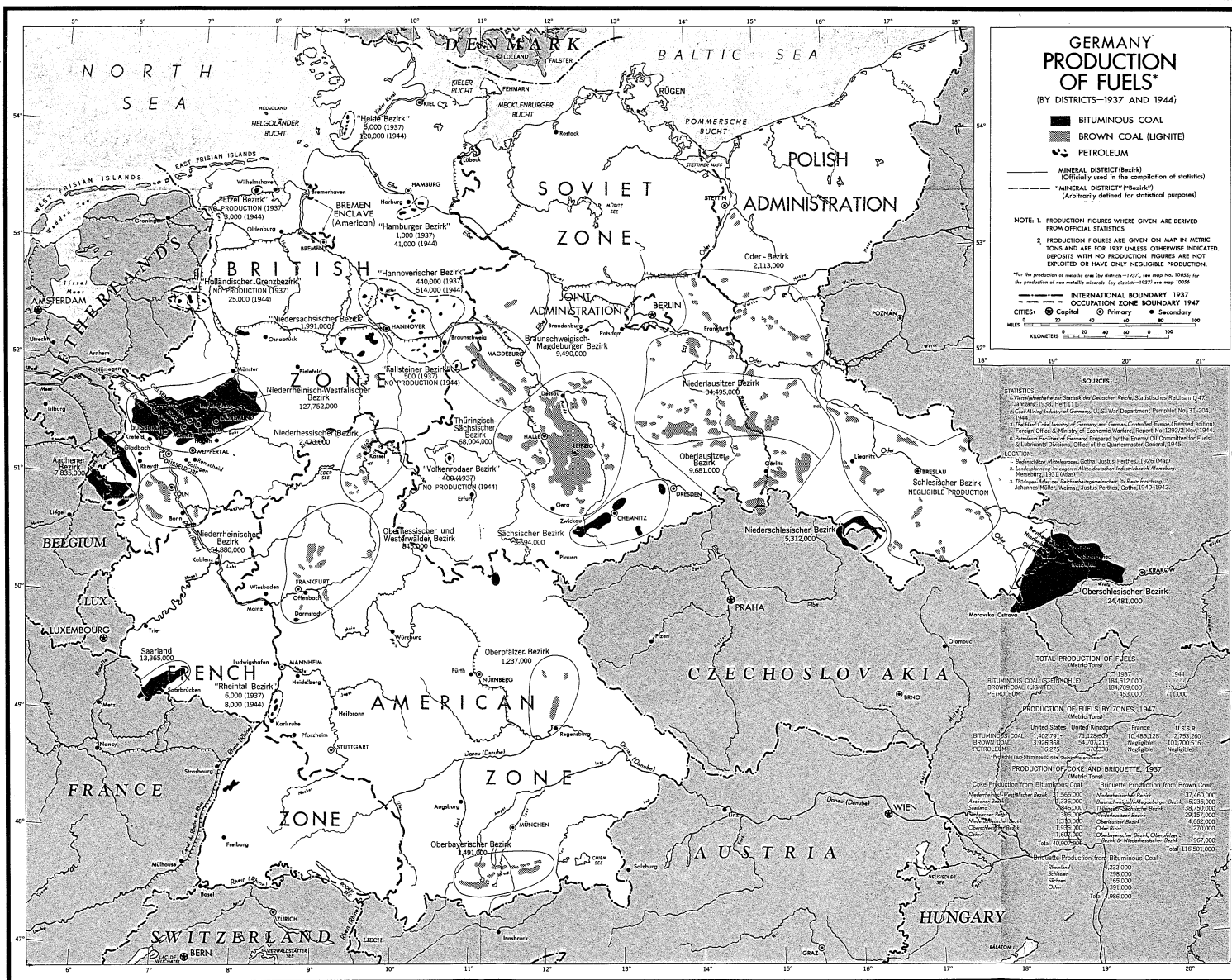
SCALE 1:2,000,000

0 25 50 75 100 125
KILOMETERS
0 25 50 75 100 125
MILES

SECRET

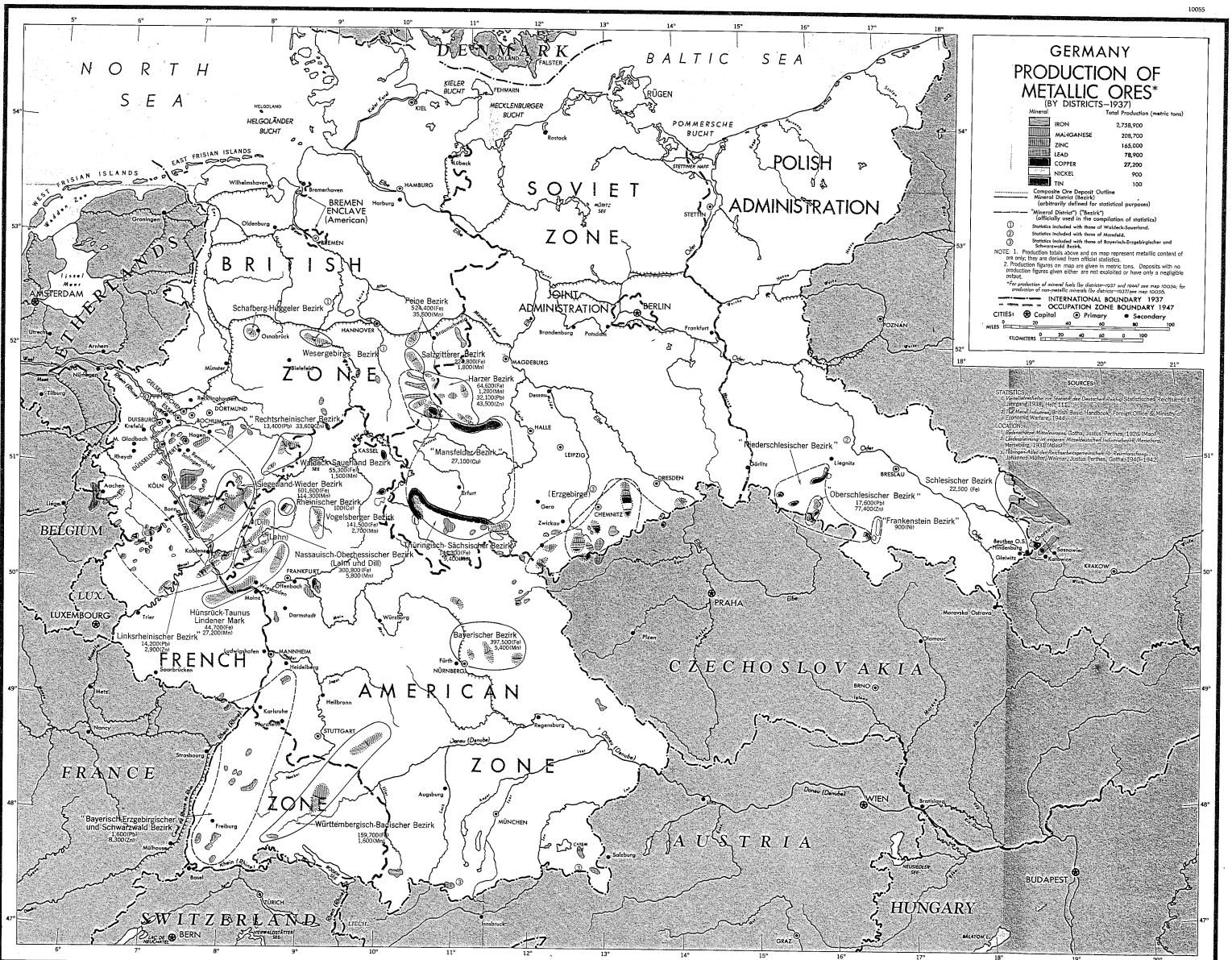
PROVISIONAL

20054



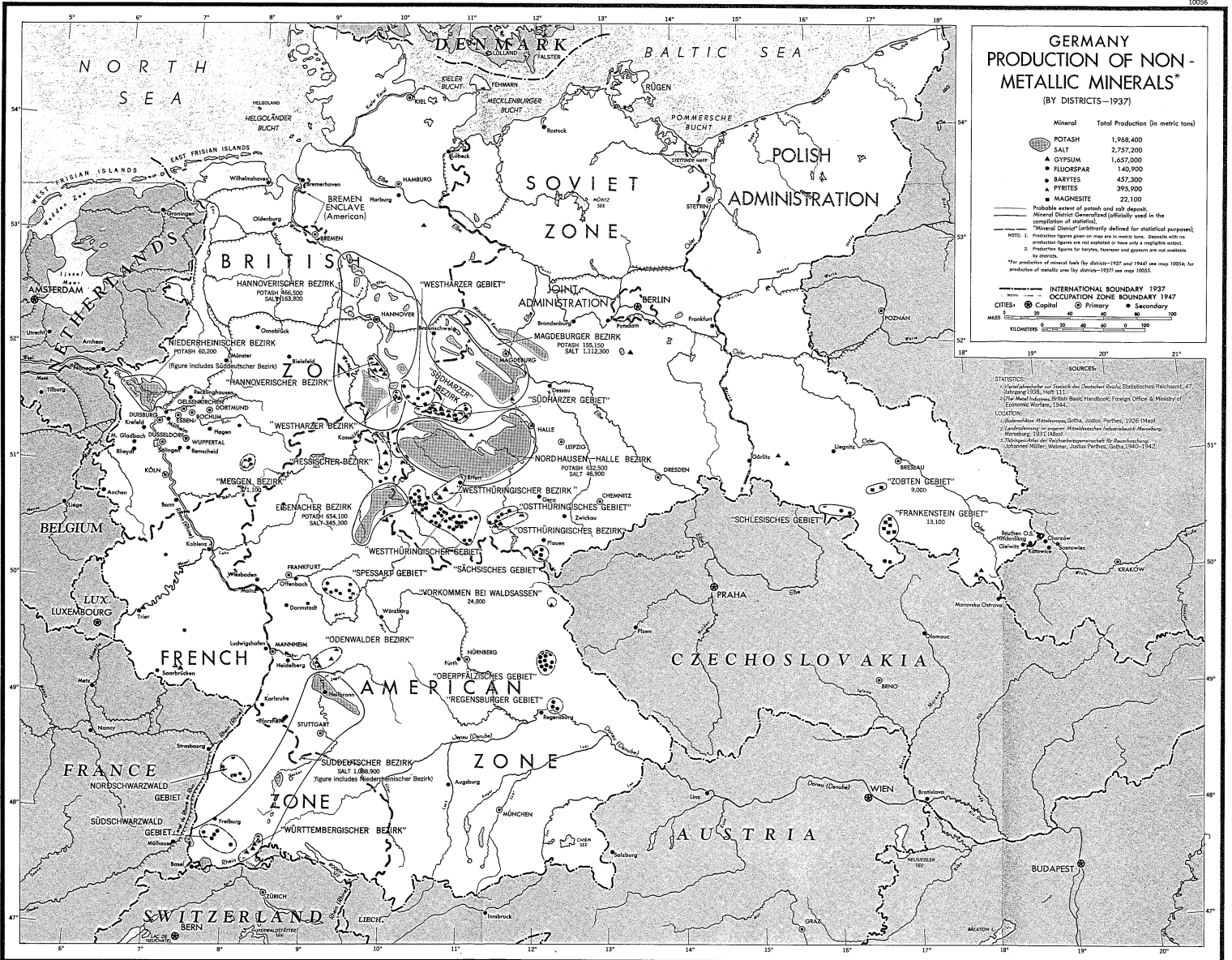
PROVISIONAL

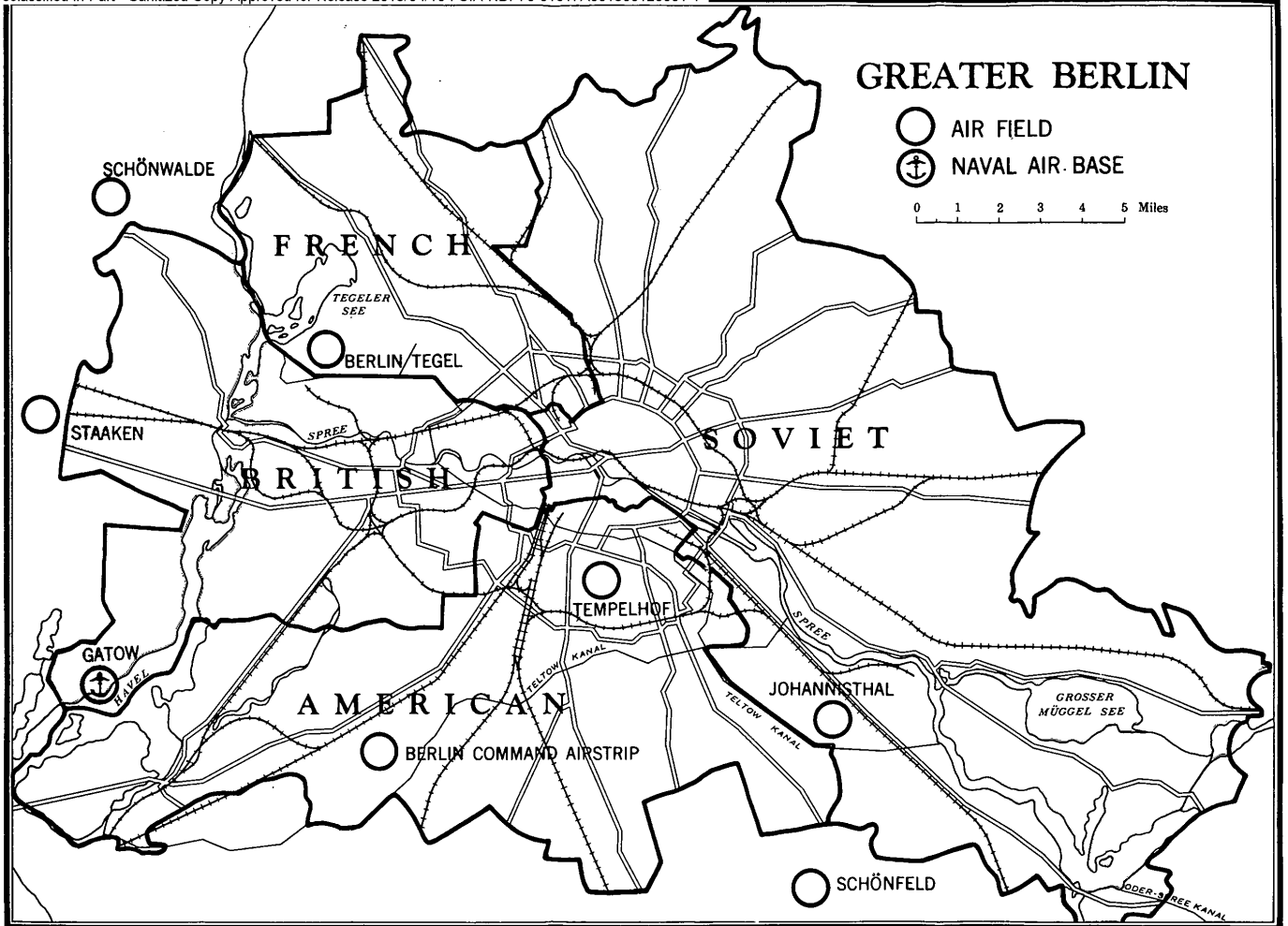
10055

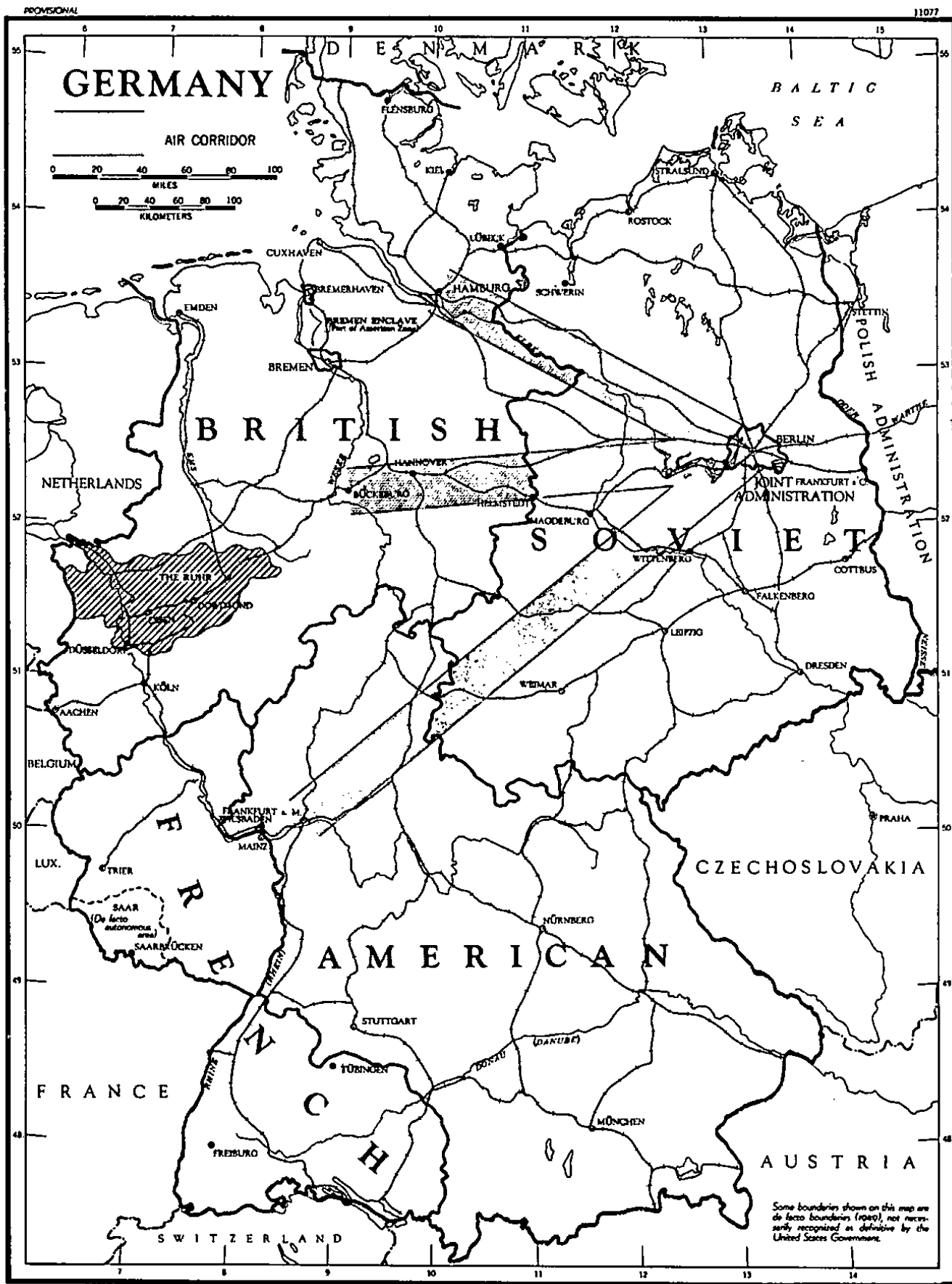


PROVISIONAL

10056







11077 Map Branch, CIA, 3-49

CIA Reproduction

17 S.

1949 DEC 20 09 10

SECRET

~~SECRET~~

341

RECORD COPY

CENTRAL INTELLIGENCE AGENCY

GERMANY (SR-20)

Chapter II and Summary

Published 1 March 1950

NOTICE TO HOLDERS OF CIA REPORT ON GERMANY (SR-20)

The Summary, Chapter II, and a revised Table of Contents for SR-20 are forwarded here-with for inclusion with the remainder of the report previously distributed. The original Table of Contents may be destroyed.

RECORD COPY

STAT

Document No. 001

NO CHANGE in Class.

DECLASSIFIED

Class. CHANGED TO: TS S C

DDA Memo, 4 Apr 77

Auth: DDA REG. 77/1763

Date: 01 FEB 1979 By: 024

~~SECRET~~



F13

S E C R E T

DISSEMINATION NOTICE

1. This copy of this publication is for the information and use of the recipient designated on the front cover and of individuals under the jurisdiction of the recipient's office who require the information for the performance of their official duties. Further dissemination elsewhere in the department to other offices which require the information for the performance of official duties may be authorized by the following:

- a.* Special Assistant to the Secretary of State for Research and Intelligence, for the Department of State
- b.* Director of Intelligence, GS, USA, for the Department of the Army
- c.* Chief, Naval Intelligence, for the Department of the Navy
- d.* Director of Intelligence, USAF, for the Department of the Air Force
- e.* Director of Security and Intelligence, AEC, for the Atomic Energy Commission
- f.* Deputy Director for Intelligence, Joint Staff, for the Joint Staff
- g.* Assistant Director for Collection and Dissemination, CIA, for any other Department or Agency

2. This copy may be either retained or destroyed by burning in accordance with applicable security regulations, or returned to the Central Intelligence Agency by arrangement with the Office of Collection and Dissemination, CIA.

DISTRIBUTION:

Office of the President
National Security Council
National Security Resources Board
Department of State
Office of Secretary of Defense
Department of the Army
Department of the Navy
Department of the Air Force
Joint Chiefs of Staff
Atomic Energy Commission
Research and Development Board

S E C R E T

SECRET

SR-20

GERMANY

TABLE OF CONTENTS

SUMMARY

CHAPTER I—POLITICAL SITUATION

	Page
1. GENESIS OF THE PRESENT POLITICAL SYSTEM	I - 1
2. PRESENT GOVERNMENTAL STRUCTURE	I - 4
3. POLITICAL PARTIES AND CURRENT ISSUES	I - 5
a. Soviet Zone	I - 5
b. UK Zone	I - 7
c. French Zone	I - 9
d. US Zone	I - 10
4. OTHER INFLUENTIAL GROUPS	I - 14
5. THE BERLIN SITUATION	I - 16

CHAPTER II—ECONOMIC SITUATION

1. GENESIS OF THE PRESENT ECONOMIC SYSTEM	II - 1
2. DESCRIPTION OF THE PRESENT ECONOMIC SYSTEM	II - 2
a. Agriculture	II - 2
b. Natural Resources	II - 6
c. Industry	II - 12
d. Financial	II - 21
e. International Trade	II - 30
3. ECONOMIC STABILITY	II - 34
a. Western Zones	II - 34
b. Soviet Zone	II - 35

CHAPTER III—MILITARY SITUATION

1. ORIGIN OF THE PRESENT MILITARY SITUATION	III - 1
2. STRENGTH AND DISPOSITION OF ARMED FORCES	III - 2

CHAPTER IV—STRATEGIC CONSIDERATIONS AFFECTING US SECURITY

1. GENERAL	IV - 1
2. POLITICAL FACTORS	IV - 2
3. ECONOMIC FACTORS	IV - 3
4. MILITARY FACTORS	IV - 4

CHAPTER V—PROBABLE FUTURE DEVELOPMENTS AFFECTING US SECURITY	V - 1
--	-------

APPENDIX A—Terrain and Climate

APPENDIX B—Significant Communications Facilities

SECRET

SECRET

APPENDIX C—Population Statistics and Characteristics

APPENDIX D—Significant Biographical Data

APPENDIX E—Chronology

MAPS:

Germany—Principal Roads and Railroads

Germany—Principal Industries

Germany—Production of Fuels

Germany—Production of Metallic Ores

Germany—Production of Non-Metallic Ores

Berlin

Germany—Occupation Zones, Air Corridors

SECRET

SECRET**ENCLOSURE B****DISSENT OF THE INTELLIGENCE ORGANIZATION, DEPARTMENT OF STATE****Chapter II and Summary***

The organization for Research and Intelligence in the Department of State dissents from SR-20 (Chapter 2 and Summary) because it considers the report an inadequate picture of the present German economic situation even though the data given in the report appear generally accurate.

Many important current issues such as the Ruhr problem, foreign trade prospects, trade between western and eastern Germany, fiscal and financial policies, investment needs, the effects of ERP on the German economy, are either omitted entirely or discussed inadequately. The two year plan for the Soviet Zone as well as a number of other important issues are mentioned in the summary but not developed in the body of the report.

Although the report purports to be up-to-date as of September 1, 1949, many facts and figures lag behind that date. For example,

the application beginning in May 1949, of the exchange rate DM 1=\$0.30 to imports of foodstuffs, and the resulting problem of food subsidies is omitted. Other important events, such as the devaluation of the mark and the new decisions on dismantling have been omitted because they occurred after September 1. These events are of such far-reaching importance that an adequate picture of the German economy cannot be given unless the deadline is extended to include them.

In relation to matters that the report does include, focus and emphasis are often distorted, in that the relative space given to various subjects is frequently out of proportion with their relative importance.

The conclusion is that SR-20 (Chapter 2 and Summary) does not enable the reader to obtain a reasonable and adequate impression of the present economic state of Germany.

* Chapter II and the Summary were issued after the publication of the remainder of the report and were therefore reviewed separately by the IAC agencies.

SECRET

SECRET

SUMMARY

After the establishment of the German Empire in 1871 by Bismarck, Prussian influence and Prussian bureaucratic methods permeated the rest of Germany, centralization of the government was heightened, and federalistic elements were correspondingly weakened. This development was interrupted only slightly by defeat in the first World War and the establishment of the more liberal but ephemeral Weimar Republic. Under Nazi control the unitary or totalitarian principle of the state reached its apotheosis. Total defeat in the second World War left the Germans powerless to decide their own immediate fate, but it has not materially weakened their attachment to the strongly centralist and nationalist principles to which they have been accustomed under a variety of regimes.

The objective of Allied occupation policy in the Potsdam Agreement was to encourage the political reconstruction of Germany along decentralized federalistic lines, but the division of the country into four zones created a pattern of conflicting ideologies which ultimately crystallized into the present split between the Soviet Zone and the three united western zones. Potsdam political principles were not applied uniformly by the four powers, and the development of German political parties was largely a reflection of the ambitions of the individual occupying powers. In the Soviet Zone the Communist Party (SED), although numerically the weakest, enjoyed a dominant position by virtue of Soviet military support. In the French Zone the occupying power favored the German particularist parties which have always opposed a close union with the German Reich. Only in the US and UK Zones were political parties permitted a more nearly normal development, although here again subordination to the authority of the occupy-

ing power resulted in an avoidance of responsibility on the part of German political leaders and a general apathy on the part of the electorate. In the three western zones the Communist Party (KPD), in addition to being under close surveillance by the authorities, has failed to attract any substantial support and is therefore a negligible factor except for its rather limited subversive potentialities. Conversely in the Soviet Zone, opposition parties have existed only upon the sufferance of the Soviet military authorities, and their ranks have been repeatedly purged of elements considered dangerous to Communist control. Consequently, to the regret of all Germans, the country has been split into Communist and non-Communist controlled areas.

Quadripartite control of Germany through the Allied Control Council in Berlin was never successfully implemented because of the obstructive attitude of the USSR and, to a lesser extent, of France. In March 1948 the Council ceased to function on a quadripartite basis when the Soviet representative withdrew on the ground that the steps taken by the US and the UK to reorganize and strengthen the political machinery of the Bizon constituted an infraction of the Potsdam Agreement. The USSR thereupon reorganized and activated the German Economic Commission (DWK) for the Soviet Zone by conferring upon it extensive powers over the zonal economy and by staffing it with reliable German Communist leaders. The police powers of the German Administration of the Interior (GAI) were placed upon a more effective basis, and the exploitation of such popular front agencies as the People's Congress (*Volkskongress*) and the People's Council (*Volksrat*) for propaganda purposes was greatly increased. The

Note: The intelligence organizations of the Departments of the Navy and the Air Force have concurred in this report. The Department of the Army has concurred in this report with the exception of Chapter II on which it had no comment. For dissents by the Department of State, see Enclosures A and B following Page V-3. The report contains information available to CIA as of 1 September 1949.

SECRET

i

SECRET

Soviet Zone was thereby provided with the framework for an eastern German state.

In western Germany, as a result of the London Agreements of 1 June 1948, a parliamentary council, which convened at Bonn early in September 1948, drew up a basic law, in lieu of a formal constitution, for the new western German Federal Republic. The Federal Republic includes all three west German occupation zones and replaces the bizonal economic control mechanisms established in June 1947. After the formal approval of the Bonn Constitution on 23 May 1949, elections were held throughout west Germany on 14 August, and the new government was formally established in September 1949. On 21 September, Military Government came to an official end, and supreme authority in western Germany was assumed by the Allied High Commission, composed of a civilian High Commissioner from each of the western occupation powers. By the establishment of a unified but federalistic west German Government, and with the spheres of Allied and German responsibility delimited in an Occupation Statute, the Western Powers hope to advance German political maturity and stability and economic recovery as part of the general program for reviving and strengthening Western Europe.

The emergence of Berlin as the principal point of tension between the USSR and the western Allies has greatly modified the character of the government of that city. The Soviet blockade, begun in June 1948, was countered by the US/UK airlift for the supply of the western sectors from 26 June 1948 to 30 September 1949. The breakup of quadripartite control, which followed the institution of the blockade and airlift, resulted ultimately in a complete division in the city administration. This division was climaxed by the establishment of a Soviet-controlled east Magistrat, and the election of a new SPD-dominated west Magistrat five days afterward on 5 December 1948. The western-sector city government, although handicapped by straitened finances and the gradual paralysis of west Berlin's economic life, has nevertheless continued to provide effective government. On 12 May, presumably as a result of the success of the airlift and the firm resistance of the Western

Powers and the west Berlin population to Soviet pressure tactics, the USSR lifted the blockade. After the Paris CFM meeting in May and June 1949, the military authorities of all four powers were directed to discuss the normalization of city services. To date, however, little has been achieved by these discussions, and Berlin remains substantially as it was before the CFM, although the once acute East-West tension has been eased considerably.

Economically, the damage to the vast industrial complex of prewar Germany left a void in central Europe of the utmost significance to US interests. For many years the German system was so closely integrated with the economies of other European countries that its impairment and dislocation has thrown the old order of things badly out of balance and forced an uneconomic reorientation of European trade, commerce, and industry. The countries of Western Europe have had perforce to depend upon the US, in the absence of their former German markets or sources of supply, as the only nation capable of supplying required goods. The economies of Eastern Europe, on the other hand, are under the domination of the USSR, which operates on entirely different principles, as a consequence of which economic activity is directed toward attainment of political objectives rather than toward maximizing incomes. Consequently, Germany has become a land across which normal travel and trade are very difficult.

From the outset of the occupation the Allied powers pursued divergent economic as well as political policies in Germany. The USSR methodically stripped the Soviet Zone not only of its war potential but also of a good deal of its industrial capacity by a rigorous policy of reparations, dismantling, exports of raw materials and consumer goods on the Soviet account, expropriations, and confiscations. What remained in the zone was not sufficient to meet the minimum needs of the population, which has been exploited systematically for the benefit of the occupying power. The USSR later reversed this policy and built up basic industries, while private enterprise was consistently discouraged if not eliminated in many fields. Most of the production was sent

SECRET

to the USSR as reparations. State-owned enterprises receive heavy subsidies from the German *Laender* under Soviet direction, and their uneconomical operation is a heavy drain upon the zonal economy. Soviet land reform disorganized zonal agriculture and produced serious food crises in what was once a surplus agricultural region in prewar Germany. Nevertheless, the USSR has maintained an industrial production level satisfactory for its own purposes, compensating for shortages and other production difficulties by intensifying the exploitation of German labor. Since the good harvest of 1948, the USSR has been able to increase considerably the basic ration as well as the amounts of food flowing into the state-owned "free shops." The Allied counterblockade established in July 1948 aggravated internal difficulties somewhat and compelled the USSR to postpone integration of the Soviet Zone economy with the satellite region until the Zone could occupy a stronger economic position to support Soviet policies. Industrial expansion under the Two-Year Plan of the German Economic Commission (DWK) of the Soviet Zone is expected to effect improvement in the zonal economy, in conjunction with increasing trade with the countries of Eastern Europe.

In the western zones France, in the past, followed an economic policy somewhat similar to that of the USSR although on a less impressive scale. The French occupation forces lived off the land, and French expropriation of German industry was carried on in a variety of ways. Consequently, economic recovery in the French Zone lagged far behind that of the Bizone and only substantial assistance under the European Recovery Program averted an almost total collapse. Under the terms of the trizonal merger, signed 18 October 1948, France began to align its policies with those of the US and the UK in the interest of an overall rehabilitation of western German industry and agriculture. Basic rations for the normal consumer were substantially increased, occupation costs adjusted to relieve the financial burden on the German *Laender*, and the export-import trade of the zone gradually integrated with that of the Bizone.

Upon the US has fallen most of the burden of reactivating the western German economy. War damage and the disruption of transportation facilities had brought industry almost to a standstill at the beginning of the occupation. The influx of displaced persons increased the population 25 percent and created a critical food problem with which the depleted agricultural resources of western Germany could not cope. Heavy imports of food and essential raw materials were required to keep the economy operating on a bare subsistence level. Despite these efforts, little improvement was effected during the first three years of the occupation. Export trade had practically disappeared, money had lost value, and barter became the principal means of commercial intercourse. Under such conditions, key industries could not be rehabilitated, and most consumer goods were unobtainable except in the black market. German discontent as a result of this economic stagnation and the punitive policies of the Allies culminated in a series of protest strikes and demonstrations in 1947 and early 1948. The June 1948 currency reform furnished the Germans with an incentive to cooperate in raising the general level of their economy in line with the European Recovery Program, under the stimulus of considerable ECA assistance. Greater economic responsibility was accorded the Germans, and the next nine months witnessed a marked increase in industrial productivity, export trade, and domestic sales. The general shortage of investment funds, which also resulted from currency reform, began after March 1949, however, to result in a temporary stagnation of the west German economy.

In its present relatively helpless condition Germany presents no military threat to the US, although the extent to which the war spirit has been chastened by defeat or by the postwar Allied policies of denazification and demilitarization is problematical. The country still possesses considerable war potentials in manpower, natural resources (principally coal), production facilities, and the technical skill and ability that can be utilized in war preparations by such a power as the USSR if bent on military aggression. As the major

point of contact between the policies and physical forces of the US and the USSR, Germany plays an important role in the East-West struggle and is of utmost strategic significance to the US. Although the European aid program appears to have given the western Allies the advantage in the "cold war" for Europe, the remoteness of the US from the scene of ideological conflict, the propinquity of Soviet military power, and the still unsettled political and economic condition of Western Europe make uncertain the outcome of the struggle between democracy and Communism. So far the German people have shown no disposition to welcome Communism or the reappearance of a dictatorship, this time controlled from Moscow. The presence

of strong nationalistic elements hostile to occupation policies and confident of coming to an eventual arrangement with the USSR poses more of a threat to democratic institutions in western Germany than does any actual danger from Communist infiltration.

While it is improbable that the USSR will resort to war as a result of conditions in Berlin or elsewhere in Germany, the USSR has 375,000 troops stationed on German soil, or nearly twice the number maintained in Germany by the western Allies. Moreover, the Soviet Zone has organized a police force, including para-military police, to supplement the strength of the Red Army in the event of hostilities.

SECRET**CHAPTER II****ECONOMIC SITUATION****1. Genesis of the Present Economic System.**

The prewar economic system of Nazi Germany was the result of the same detailed planning and foresight that made the German military machine such an effective weapon of aggression. Private enterprise in name only, it was subject to a very large measure of central governmental control. The economy was so ordered as to afford maximum support of the military machine. Germany possessed great aptitude for development along scientific, technical, and industrial lines. This, together with the fact that the Allies in 1919 after the defeat and dispersal of the German army left the German productive capacity virtually intact, made it a relatively simple matter for the Germans to regain and even to surpass pre-1914 levels of production and national income. It was thus possible for their military organization to become more menacing to international security than ever before.

Situated in the middle of Europe, with few natural resources, a soil depleted by generations of intensive cultivation, and with limited access to the sea, Germany in the course of time surmounted these handicaps and became a highly industrialized economy, in which foreign trade played an important part. Organizational weaknesses exposed by the first World War, such as the failure to foresee and prepare for a war of attrition based on an economic blockade of the country, were corrected to a large extent during the subsequent years of peace. In 1939 Germany was a highly coordinated, completely integrated state, self-sufficient to the point of being able to launch and sustain another world conflict of far greater magnitude than the first.

The Germans compensated to a remarkable extent for the paucity of their natural resources by development of synthetic substitutes and by building up stockpiles of essential materials. Also through various exchange

controls and by pursuing calculated trade policies, Germany managed to exert pressures on the economic life of many smaller countries, involving them in long-term commitments and increasing their dependence upon the Reich as a market for exports and a major source of imports. Where this was impractical, the Germans were able to exercise important economic controls in rival countries over prices, production, and distribution of various commodities in world markets through the formation of international cartels. The manipulation of world trade and world resources by German industry through cartel arrangements not only strengthened Germany's ability to make war, but weakened the defensive position of its potential rivals by limiting or reducing their supply of certain strategic commodities. French aluminum production, for example, was curtailed by an agreement which resulted in the export of bauxite ore to Germany, which in turn sold finished aluminum to France. This arrangement seriously handicapped the French upon the outbreak of war in 1939.

Long before 1932 much of German industry and trade was organized into various cartels which proved to be most convenient to the Nazis for the task of mobilizing and "rationalizing" industry for war. German business as a whole was grouped in fully representative trade associations, which had developed joint bodies on a national scale. There were five such bodies (*Spitzenverbände*)—for industry, trade, power, banking, and insurance. After 1933 the Nazis kept the traditional form of these associations but made membership compulsory and introduced the "leadership" principle: appointment from above in place of election from below, with the Minister of Economics in supreme control. Although prevented by statute from engaging in price-fixing and other monopolistic practices, which were left to cartels, the association in many

SECRET

II-1

SECRET

instances was identical as to membership with the cartel. Cooperation between the two was directed by law, the object being to "remove the obstructions and difficulties caused by multiplicity of industrial organizations" and to "establish a comprehensive, tight and uniform organization" instead.

Agriculture was also unified and centralized under the Nazi regime by the formation of the Reich Food Estate (*Reichsnährstand*) with powers of internal administration that extended to price-fixing and marketing. The Administrative Department pushed agrarian improvements through the media of Regional and District Peasant Bodies and controlled distribution through Marketing Boards. Farmers were persuaded to introduce or augment crops that would reduce the deficiency in domestic food production. The high costs involved were offset by high prices and special Reich subsidies. The Food Estate had complete authority over every phase of Hitler's battle for agrarian self-sufficiency, including farm resettlement, mechanization of farms, and land reclamation, and it operated the rationing system which had been put into effect several years before the outbreak of the war.

Such absolute control over the national economy enabled the authorities to shift entire plants, as well as large segments of labor and the agricultural population, according to the demands of a specific industry or a specific government policy. Throughout the war the Nazi government maintained the German economy at a remarkably high production level, despite blockade, damage from the air, and difficulties that arose over distribution and supply as Hitler's armies spread over most of Europe.

Central control of the economy by the Reich government terminated abruptly with the defeat of the German military forces. Thereafter, economic controls, policies, and procedures prevailing in the four zones of occupation were uniform only to the extent that agreements were reached in the ACC.

Although in the early months of occupation some measure of uniformity prevailed, generally economic policies pursued in the zones have varied in accordance with differences in the economic philosophies and interests of the

several occupying powers. This has caused a cleavage, widened with the passage of time, in developments in the western zones and the Soviet zone. In the western zones, for example, control of industry tended to revert to private owners under local German authority and free-market determination of prices has been restored for nearly all commodities. In the Soviet zone, socialization of various industries has been effected and Soviet-owned or controlled firms have been created, while prices are still generally controlled by German authorities in the zone as directed by Soviet Military Government authorities.

Uniform economic policies in the US-UK zones were assured with the economic merger of the two in January 1947. The gradual merger of the French Zone with the "Bizonal" area beginning in October 1948 tended to make western Germany an economic unit. The merger was not completed until the western German Government was established in September 1949.

2. Description of the Present Economic Situation.

a. Agriculture.

One of the most critical hindrances to Germany's postwar recovery was the insufficiency of food to supply the needs of the population, despite heavy relief imports. The German agricultural economy, even after Hitler initiated his agrarian "production battle" in 1934, has been unable to increase to any appreciable extent the area under cultivation, 60 percent of the total area already being improved farmland. Although Nazi land reform, farm resettlement, and land reclamation projects provided a larger percentage of small farms than formerly, there was not a significant increase in cultivated land because of the large areas taken over for airfields and other military installations. Poor soil forced more extensive use of natural and artificial fertilizers, but during the war years a shortage of fertilizers reduced the productivity of German farmlands.

Improved farming methods and governmental subsidies, plus rigorous control of the distribution, consumption, and stockpiling of food and fodder supplies, enabled Germany to

achieve wartime self-sufficiency by 1938 in wheat, vegetables, and dairy products other than butter. Bread and potatoes formed the basis of the normal diet, and 65 percent was supplied by the eastern area. However, the total indigenous food supply to all of Germany was only 85 percent of total consumption. Vegetable oils and feed for livestock remained the weak points in the wartime agricultural economy. Only 48 percent of required table fats (butter, lard, margarine) and 7.5 percent of necessary technical fats for industrial purposes could be produced from sources within the nation. Western Germany as now constituted, cannot supply more than 50-60 percent of its food requirements.

The hectarage, estimated production, and imports of principal crops in the Bizone are as follows:

	HECTARAGE		PRODUCTION (Metric Tons)		IMPORTS	
	1938/39	1948/49	1938	1948/49	1947	1948
Bread Grains	2,414,000	2,138,000	5,584,000	4,518,000	4,334,300	6,326,000
Total Grains	4,376,000	3,651,000	10,260,000	7,419,000		
Potatoes	951,000	1,019,000	17,492,000	19,055,000	26,800	347,500
Sugar Beets	148,000	146,000	4,770,000	4,348,000	53,700 (sugar)	634,900 (sugar)
Fodder Pulses	77,000	93,000	157,000	134,000	58,800	102,900

In the postwar period in all zones, almost all farms suffered from lack of fertilizers, seeds, tools, fuel, and spare parts for mechanical equipment. Despite these production difficulties the relative advantages enjoyed by the farming population with respect to available food supplies increased the ill-will of urban workers toward the authorities responsible for the rationing system and toward refugees whose presence was an added strain on the food supply. Farmers also tended to withhold delivery of their assigned food quotas, and thrived on black market trading. Urban workers, unable to satisfy their demands through legal channels, went directly to the farmers to trade their services or possessions for food. This situation greatly improved after the currency reform in June 1948, when

farm products once again came to be released for distribution through regular channels.

The French Zone, smallest of the four, has felt the food shortage more keenly than the rest, despite heavy imports. The official daily ration in 1947 averaged only about 1,200 calories for the normal consumer, but usually less than this amount was available. A good 1948 harvest improved the food situation, although French requisitions continued to limit amounts consumed by the population. Total daily food consumption by the non-farm population in the French Zone is now estimated to be around 2,300 calories.

Because of the influx of expellees, refugees, and repatriates, the Bizone is now very densely populated, the population having increased 25 percent since 1939. At the same time, food production for the area in 1948

was 10-15 percent less than prewar. Cattle numbers in the bizonal area in December 1948 were 2 percent larger than the year before, but 15 percent below the 1936-38 average. Efforts to reduce fodder crops in order to produce more food for direct human consumption were successfully resisted by German farmers, and increased fodder crop hectarage in 1949 improved the livestock situation considerably, with a consequent improvement in the meat, fat, and milk ration.

During 1936-38 average food production in the bizonal area provided approximately 1,450 calories daily per person for the non-farm population. Average non-farm consumption in these years was about 2,900 calories per person daily in the bizonal area. In the first half of 1949 the average non-farm consumption in the Bizone was around 2,450 calories,

which was about 600 calories more than the official ration of 1,850 calories for the normal consumer. Estimates of the 1949 harvest for western Germany, including the French Zone, indicate that the breadgrain crop is substantially above that of 1948 because of a 20 percent larger yield per hectare. The total breadgrain production was 5.88 million tons, and with imports of 2.5 million tons assures the food supply of the Federal Republic and western Berlin. The potato crop, however, was reduced about 20 percent by drought, which also affected other root crops such as sugar beets and fodder beets.

Under the European Recovery Program, western German economic plans call for full land reform, the adoption of various scientific measures, increased production of fertilizers, and imports of food and other agricultural supplies. The German diet has been recently supplemented by an increased use of fish. The small fishing fleet is being repaired and rebuilt to authorized capacity as rapidly as

shortages of materials and fishing equipment will allow.

The Soviet Zone has the largest land area and is the most important zone agriculturally. The zone possesses 35 percent of the total arable land which accounted for 40 percent of prewar breadgrain and potato crops, and half the number of sheep in Germany as now defined. Much of the land reform which the Moscow Conference directed should be finished in 1947 was accomplished in the 1945 initial denazification procedure. The power of the large estate owners was eradicated by expropriation with compensation of all farms over 100 hectares (247 acres), and more than 2 million hectares of land were distributed between the time of occupation and March 1947. Ruthless implementation of this policy created new problems, however, and only 25 percent of the crop land was producing at normal capacity in the spring of 1947 while the rest was producing far below normal or not at all.

GRAIN AREA, YIELDS, AND PRODUCTION SOVIET ZONE OF GERMANY FOR PREWAR, 1948 and 1949¹

Crop	Area (1000 hectares)			Yield (centners per hectare)			Production (1000 metric tons)		
	Prewar Average	1948	1949	Prewar Average	1948	1949	Prewar Average	1948	1949
Wheat	633	474	500	24.6	19.8	20.0	1,554	939	1,000
Rye	1,214	1,290	1,280	17.1	14.2	14.0	2,078	1,830	1,792
Barley	460	250	300	22.4	16.5	16.0	1,029	412	480
Oats	741	562	600	21.5	14.2	14.0	1,590	795	840
TOTAL	3,048	2,476	2,680				6,251	3,976	4,112

¹ Estimated.

LIVESTOCK NUMBERS IN THE SOVIET ZONE OF GERMANY AS OF 3 DECEMBER for 1938, 1945, 1946, 1947 and 1948 (In 1000 head)

ITEM	1938	1945	1946 ¹	1947	1948
Horses	810	590	620	650	665
Cattle	3,644	2,401	2,500	2,783	2,879
Hogs	5,689	1,179	1,900	2,074	2,617
Sheep and Goats	2,438	1,272	1,600	1,758	2,121
Poultry	21,251	5,947	8,000	13,451	15,764

¹ Estimated.

SECRET

Poor harvests in 1947 resulted in severe food shortages throughout the Soviet Zone in the spring of 1948. The shortages were met in part by imports from the USSR and the satellite states. Because of increased hectarage and fertilizer allocations, as well as better weather, the 1948 crop was 25 percent larger than the 1947 crop, and resulted in a considerable improvement in the food situation, even though the USSR continued to requisition scarce items for the Red Army and for export. Although it is difficult to determine quantitatively the average food consumption in the Soviet Zone, recent estimates indicate that the non-farm population in 1948-49 was consuming around 2,300 calories daily. The meat and fat situation has failed to show material improvement; and fish, sugar, and ersatz products continue to be substituted on the meat and fat ration. Peasants' mutual aid associations are now organized along collective lines, and further land reform in this direction is reported in prospect.

Prewar Germany utilized tremendous quantities of commercial fertilizers, and as a result produced very high yields per unit of area on relatively poor soils. Intensive cultivation during the war to obtain maximum food supplies further depleted the soil and increased Germany's dependence on artificial fertilizers.

Before the war Germany was the principal nitrogen producing country of the world. Of its production, which exceeded 700,000 tons for the crop year 1938-39, 70 percent was utilized by agriculture, 16 percent by industry, and the remainder exported. Output was reduced about 50 percent by war damage and other causes, and efforts on the part of the US and UK to provide fertilizer imports in order to restore food production to the highest possible level were circumscribed by the worldwide need for fertilizers, particularly nitrogen. By the end of 1948 nitrogen fertilizer production was back to normal and production almost doubled in 1949.

The bulk (61 percent) of the enormous German potash deposits, estimated at 20 billion tons, lie in the Soviet Zone. Thirty-six percent of the German deposits are in the Bizone where requirements in 1946 exceeded production by 40 percent. Because the barriers in

the way of interzonal trade have operated to prevent the western zones from obtaining substantial amounts of potash from the Soviet Zone, bizonal resources have been intensively exploited. Potash production in the UK Zone, where the principal west German mines are located, amounted in 1948 to 2.41 million metric tons of crude potassium salts. This rate of output was increased nearly 50 percent in the first six months of 1949, which was in excess of requirements and left a small surplus for export.

Because of the general economic dislocation, German agriculture was able to obtain less than half its estimated fertilizer requirements in 1946 and crop yields were 20 percent lower than in prewar years. The Bizone could meet only 37 percent of its potash needs, and 34 percent and 12 percent respectively of its nitrogen and phosphate requirements.* The situation failed to improve in 1947 when bad weather was also a factor in retarding crop production. It was impossible to come within 35 percent of achieving the 1,550 calorie ration level for the normal consumer from indigenous food production, and this necessitated the import of 4.4 million tons of food at a cost of approximately \$600 million. In eastern Germany potash requirements were exceeded by 7 percent, but in the other categories the Soviet Zone was worse off than the western zones, obtaining only 22 percent of estimated nitrogen needs and 5 percent of required phosphates. The situation for all Germany improved considerably in 1948 because of larger fertilizer allocations and better weather conditions. Although eastern Germany can still produce food surpluses, the prospect for western Germany's becoming self-sustaining remains poor in view of the increased population and limited farming area.

Prewar production of potash in the Soviet Zone was over a million tons annually. In 1946, the SMA quota for the zone was 800,000 tons, with production at least 20 percent under this figure because of war damage, power shortages, transportation difficulties, and So-

* In the first six months of 1949, the supply increased to 122 percent of potash needs and 89 and 95 percent respectively of nitrogen and phosphate requirements.

SECRET

II-5

SECRET

viet mine dismantling. Actual production in 1948 was 917,000 tons, of which 60 percent was applied to agriculture and industry in the Soviet Zone and the rest taken for reparations or export.

b. Natural Resources.

(1) *Coal.*

Germany's most important raw material is coal. In prewar Europe, the UK alone surpassed Germany's production and export of hard coal (Steinkohle), two thirds of which came from the industrial Ruhr at the rate of about 10 million tons a month. All kinds of hard coal, containing from 5 to 40 percent volatile matter, are produced, i.e., anthracite, semi-bituminous, bituminous coals of coking and non-coking type, gas and long-flame coals. Over two-thirds of the coal mined in the Ruhr is suitable for coking. The coke ovens not only supply the iron and steel industry but are the source of a whole series of by-products important to the chemical and other industries. Brown coal, of which Germany possesses vast resources, has a high moisture content, and in fuel value nine tons of brown coal is considered the equivalent of two tons of hard coal. It is suitable chiefly for power generation and briquette manufacture.

Three-fourths of the important hard coal reserves, estimated in 1944 at 288 billion metric tons, are concentrated in the Ruhr, where the coal is found in several seams, one above the other, at depths of 1,300 to 2,600 feet, thus enabling many coal beds to be worked from a single shaft. Most of the remainder is found in Upper and Lower Silesia, the Saar, and near Aachen and in Lower Saxony. Of the total reserves of brown coal and lignite, approximately one-third is located along the lower Rhine near Cologne in the British Zone. Important deposits are found in the Soviet Zone, in the vicinity of Leipzig and east of Berlin on the Oder River. France has integrated the Saar mining region into the French economic system. The Silesian area—containing about 25 percent of the reserves of brown coal and lignite—is, with the consent of the western Allies, under Polish administration until a German peace treaty is signed. Because of the Soviet-Polish attitude toward the Oder-

Neisse boundary, quadripartite agreement on the return of Silesia is unlikely. As a result of the war, Germany will have lost one-fourth of its brown coal reserves but not more than 15 percent of its hard coal.

The recovery program for Germany has depended upon the availability of coal and steel, hence Allied efforts have been concentrated on overcoming the formidable handicaps encountered in the mines such as reduced capacity from war damage, inadequate or unskilled labor, and changes in management resulting from decartelization* and denazification procedures. Hard-coal production in the Bizone in 1946 was 55 percent of the amount dug in 1936; in 1947 it was 65 percent, and in 1948, 79 percent of the prewar figure. Brown coal output, on the other hand, has surpassed prewar levels, with the Soviet Zone producing the major share. Ruhr output has fluctuated with the individual miner as he has been affected by such considerations as the food supply, lack of clothing, consumers' goods and housing, the temporary abandonment of the trend toward socialization of the mines, and the political activities of trade union and works councils under the influence of Communist propaganda.

Whereas in 1935, German output of coal per man per day averaged 1.57 tons (as against 4.52 for the US), the present 1949 output in the Ruhr is about 1 ton per man. Until recently output per man was very much lower. To overcome this situation steps were taken by quadripartite agreement to increase miner's pay by 20 percent, to improve living conditions by granting special housing and repair priorities and to place greater managerial responsibility on German shoulders. Recruiting and incentive programs, featuring extra food-ration allotments, also produced favorable results. But the postwar daily production remained far below the hard-coal tar-

* In 1913 independent coal mines controlled over 50 percent of the coal resources, but by 1940 only 10 percent remained in independent hands. During the war this small percentage was further reduced by incorporation of some of the remaining independent mines into the Ruhr steel combines. France and the Benelux countries also have a financial stake in German coal mines.

SECRET

COAL PRODUCTION IN THE RUHR DISTRICT

	1936	1946	1947	1948	INCREASE IN 1948 OUTPUT OVER 1947		1948 PER- CENTAGE OF 1936
	<i>(in million metric tons)</i>				<i>(tons)</i>	<i>(%)</i>	
Coal	116.96	53.95	71.12	87.0	15.9	22.4	74.4
Coke	27.79	9.04	13.24	19.0	5.7	43.2	68.2
Coal briquette	4.41	1.90	2.18	3.0	0.8	36.2	67.3
Lignite	52.92	48.17	54.73	60.7	6.0	10.9	114.7
Lignite briquette	11.30	10.5	11.59	12.6	1.0	8.8	111.6
Workers Employed	284,100	320,200	390,800	409,200	18,400	5.8	44.0

get of 350,000 tons daily until September 1948, when the release of hoarded goods brought about by the currency conversion, the effects of the better food situation, and the larger number of coal miners employed, began to be felt. Average daily production reached 335,000 tons in the first half of 1949, and increased allocations to German industry brought about a marked improvement in the general economic situation. Of the coal mined, German industry receives about 50 percent, of which the iron and steel industry receives about one-fourth. The railways receive about 10 percent, domestic consumers about 6 percent, and the occupation forces about 4 percent. Another 10 percent is consumed by the collieries, and the rest, approximately 20 percent, is exported. France receives about 35 percent of these exports.

(2) Timber.

Slightly over a quarter (27.5 percent) of prewar Germany was covered by forest, which yielded timber as well as material for paper, wood-fiber cellulose, and other products. Despite a highly advanced system of reforestation, Germany's prewar wood supply was insufficient for its needs.

Germany emerged from the war with its forests relatively undamaged. About 40 percent of the forest area is in the US Zone, 30 percent in the Soviet Zone, and the rest divided equally between the French and UK Zones. An acute timber famine exists in all Zones despite greatly increased felling. Loss of East Prussia and the territory east of the Oder reduced the forest area of Germany by 25 percent. Present Germany has a forest area of 23.6 million acres, of which 19.5 million acres

are commercial forests. The commercial forests are estimated to be growing annually 6.8 billion board feet of timber in trees of more than 2.75 inches in diameter. Norway spruce is the most common tree in the Bizone, and spruce forests cover 40 percent of the forest area. Scotch pine covers 26 percent and beach forests 21 percent of the area. Spruce and pine furnish the ordinary construction timbers and most of the common lumber used in Germany. The total cut in 1947-49 was 7.5 billion board feet, which was greater than normal growth, and indicated a serious depletion of forest resources. At this rate of cutting, it is estimated that sawlog-size trees will be gone in eight years. Consequently, the occupation authorities have ordered a progressive decrease in the cut and are also reducing timber exports in an effort to preserve the productive capacity of the remaining German forests.

(3) Petroleum.

Germany has small petroleum resources. Eight fields in the Hanover region produced about 550,000 tons in 1938, no more than eight percent of prewar requirements. Their chief importance, however, lay in their yield of valuable light oils from which lubricants are derived. Present consumption of lubricants in the bizonal area is approximately covered by domestic production. A sudden or general increase of industrial activity, however, may cause a bottleneck in lubricants. Refineries in the UK Zone, where the only important oil fields are located, supply present restricted civilian needs in all three western zones. These plants are to be rehabilitated and modernized for refining Venezuelan and Arabian crudes.

SECRET

II-7

In 1948 the refineries processed 738,904 tons of petroleum, of which 276,000 tons were imported from Venezuela and the Near East. Domestic oil production in 1948 was 626,810 tons from 28 oil fields. Bizonal consumption of POL products in 1949 is estimated at 2.7 million tons, which will require a continuation of the strict licensing control of petroleum supplies.

The manufacture of synthetic gasoline, amounting to 2 million tons in 1938, was prohibited by the occupying powers in 1945 because of its war potential as well as its expense, one ton of liquid fuel requiring 15 to 20 tons of brown coal. Two of the six west German Fischer-Tropsch plants were maintained in operation, however, in order to reduce the cost of petroleum imports. In the spring of 1949 all facilities were ordered removed in conformity with the agreement on Prohibited and Restricted Industries. Producing nearly at capacity, Soviet Zone synthetic plants (such as the Leunawerke near Merseburg) for extracting gasoline and diesel oil from lignite and coal supplied about 14 percent of Germany's liquid fuel needs during the early war years. War damage and dismantling reduced this capacity from 2.27 million tons to approximately 1.1 million tons in 1948. The USSR has acquired the plants for the Soviet economy and is reported to have produced about 450,000 tons of gasoline and 200,000 tons of diesel fuel in 1948. Production and distribution of the estimated civilian requirements of gasoline, oil, and lubricants for 1949 will call for utilization of all undamaged and salvageable equipment in the western zones, and may require all refinery equipment in western Germany, so that no surplus has been scheduled for reparations.

(4) *Iron.*

The insufficiency of domestic iron ore was one of the most serious of all raw-material problems hampering the economic progress of Nazi Germany. The principal German iron ore deposits are in the Siegerland, Lahn-Dill, Salzgitter, and Bavarian districts. Reserves of first-grade ore were estimated in 1938 at 350 million tons and of second-grade ore at 300 million tons. Most of these deposits are

small, widely scattered, and frequently remote from coal fields.

German ore is lean, averaging less than 45 percent iron after treatment as compared to Swedish ore which ranges from 58 to 72 percent iron content or Spanish, 48 to 58 percent. Furthermore, German ore, unlike the low-grade minette ores of Lorraine, is not self-fluxing and requires expensive treatment for removal of silica and other impurities. Nevertheless, physical lack of plants to treat domestic low-grade ores was a national weakness in 1939, since Germany was dependent upon imports of foreign ores for two-thirds of its annual prewar consumption of 33 million tons. Sweden furnished almost 50 percent of these imports and France 25 percent. The phosphate derived from Swedish ores is an important source of fertilizer. In contrast to short supplies of iron, Germany had abundant coal resources, production of coking coal in prewar years being sufficient not only to meet all domestic requirements but also to provide an exportable surplus which helped pay for iron ore imports. German iron ore production in 1948 was 6.5 million tons or nearly double that of 1947 and 12 percent greater than the 1936 output. Germany was also deficient in ferro-alloys and alloy materials, such as nickel, molybdenum, chrome, and tungsten, all essential to the manufacture of high-grade alloy steel. Chrome was obtained mainly from Turkey, tungsten from the Iberian Peninsula, and nickel and molybdenum from Scandinavia.

(5) *Aluminum.*

Although German deposits were negligible, providing less than 25,000 tons of ore annually compared to imports of over 1 million tons, Germany, before the war, ranked first among the nations of the world in the capacity of its aluminum industry. Most of the bauxite ore obtained during the war came from Hungary and southeastern Europe, and, after 1940, large quantities were imported from France. During the war, annual aluminum consumption rose to a peak of around 470,000 tons of metal, with German plants producing about 65 percent of this amount. Many aluminum plants were destroyed in the

SECRET

course of the Allied invasion; others were dismantled and removed as reparations. Although production of primary aluminum (virgin ingots from bauxite) was originally banned by Allied agreement and imports were limited to 30,000 tons of metal a year, or about one-tenth the annual consumption rate for 1939-44, production of aluminum up to 85,000 tons annually is allowed under the PRI agreement. Aluminum production in 1948 from both primary and secondary sources was 42,000 tons in the Bizone. The French Zone has one aluminum plant with an annual capacity of 35,000 tons. Requirements for the Soviet Zone, which is dependent mainly on Hungary for bauxite, were stated at 60,000 tons in 1948, of which about 60 percent was estimated as available.

(6) *Zinc and Lead.*

A decade ago Germany was next to the United States and Belgium in the world smelter production of zinc and was able to supply about two-thirds of its annual consumption of 225,000 tons from indigenous ore. It shared with Yugoslavia first place among European producers of lead, although consumption was about three times the annual output of German mines. The chief sources of lead and zinc are in Upper Silesia, the Harz Mountains, and along the Rhine River, about 165,000 tons of zinc and 80,000 tons of lead being obtained annually from these deposits. Because zinc predominates two to one in the ore, Germany during the war relied heavily upon lead concentrates imported from Yugoslavia. Bizonal smelter production of zinc and lead in 1948 was only 40 percent of what it had been in 1936. Soviet Zone production in 1948 was approximately the following: recast zinc—1,298 tons; lead concentrates—741.1 tons; lead and lead alloys—11,922 tons.* (Germany's large Silesian zinc mines have been given to Poland by the USSR.)

(7) *Copper.*

Shortage of copper contributed materially to Germany's military defeat. During the war the use of copper was confined to the

* 1946 Soviet Zone zinc production was 14,000 tons and lead 6,566 tons.

manufacture of aircraft and to other essential military purposes, while aluminum was substituted for it in all commercial and domestic uses. The amount of copper mined in Germany has remained stable during the last 30 years, and production could not be essentially advanced either in the prewar years or during the war. The estimated annual mine output of finished copper was 25,000 tons, and the total refinery capacity about 300,000 tons. The copper industry was an important element in the national economy, and Germany was able to compete successfully in world markets in semi-manufactured and finished copper products, of which about 100,000 tons a year were exported. The proceeds in foreign exchange gained in this manner were sufficient not only to cover the import of copper ores, concentrates, and scrap (totalling about 260,000 tons annually) but to leave a substantial surplus for the import of other goods from abroad.

The German copper industry passed largely under Soviet control. More than 50 percent of the copper products plants and nearly all the large smelters and refineries are located in the Soviet Zone, where 90 percent of the copper is mined, most of it in the Mansfeld district of Saxony-Anhalt. Production in 1948 was 24,000 tons of copper, mainly from 1.3 percent ore. Because Mansfeld ores are sub-marginal, mining in the past was economically possible only with state subsidies, which have been continued by the Soviets and charged to the *Land* Government of Saxony-Anhalt. With the price of copper fixed at RM 735 per ton in 1948, production costs were RM 8,000 per ton, and the yearly subsidy was estimated at RM 52 million, the deficit being made up by *Land* subsidies.* The USSR has refused to permit an increase in the price of copper and is reported to have shipped large quantities to the Soviet Union, which have been credited to German reparations at the low price supported by subsidies. Ore production in 1946 was 371,000 tons, or about 40 percent of what it had been before the war. The USSR is striving to reach the prewar level and

* The world price of copper was RM 1,300 per ton in 1948.

SECRET

II-9

SECRET

has embarked upon an extensive program of mine renovation and enlargement; the output per miner, however, is still below the prewar average. Copper production in western Germany in 1949 is expected to reach 120,000 tons, of which two thirds is electrolytic and the rest fire-refined.

(8) *Tin.*

Since the Middle Ages tin has been mined in Germany from small low-grade deposits in the Erzgebirge, peacetime production averaging about 150 tons per year, 1,000 tons during the war. The average annual consumption in prewar years, however, was about 14,000 tons. The deficiency was partly filled by ore imported from Portugal, Spain, Bolivia, and the Netherlands East Indies and reduced in German smelters; in addition, some tin metal imports were required.

Germany was among the largest continental consumers and smelters of tin, with an annual smelter output of approximately 5,000 tons. In March 1946 the Allied Control Council set the permissible level of the German tin industry at one half the 1938 rate and allowed an annual maximum consumption of 8,000 tons.

(9) *Vanadium.*

An essential component of high-speed steel tools and other high-tensile, heat-resistant steel products, vanadium was the one alloying element found in Germany in quantities nearly sufficient for war needs. When nickel and chromium became very scarce early in the war, vanadium was widely substituted in their place. Three sources were available: vanadium-bearing slags from Norway, minette (low-grade) iron ores, and recovery from the Bayer aluminum process. By far the most important was the minette ore of Luxembourg and Belgium, which, before the war, enabled Germany to meet its annual requirements of about 15,000 tons. Vanadium production from iron-ore slags has been forbidden in Germany since the war under the Level of Industry Agreement.

(10) *Magnesium.*

Until 1942 Germany was the world's leading producer of magnesium accounting in

1940 for nearly 60 percent of the world supply of 36,500 tons. Magnesium output increased enormously during the war, and was used extensively in airplanes, incendiaries, rocket launchers, flares, and tracers.

Following the surrender, primary magnesium production was banned by the Allies for an indefinite period, but is being produced in the Soviet Zone at the rate of 500 tons per month.

(11) *Graphite.*

All the economically important graphite mines are located in southeast Bavaria, with small deposits in Silesia and Thuringia which yield an inferior grade of ore. The Bavarian deposits have been mined for centuries, but modern mining did not begin until the first World War. Small holdings were then consolidated into a few strong companies which, in 1938, were merged into the Graphitwerke Kropfmuehl A.G., the dominating group in the industry until the collapse in 1945. Annual production of all grades was approximately 30,000 metric tons of raw graphite; finished graphite about 8 to 10,000 metric tons.

The high melting point of graphite and its resistance to burning in air make graphite industrially useful as a refractory agent in crucibles and foundry facings.

(12) *Beryllium.*

Germany pioneered in the production of alloys from this rare metallic element, particularly in connection with beryllium-copper alloys and later on as a replacement for molybdenum and tungsten in the production of steel. Since 1935 a single plant at Frankfurt-am-Main has been the only producer of beryllium metal and oxide in Germany, the total output during the war amounting to 18.8 metric tons of oxide and 4.1 metric tons of metal. Ore supply originally came from Brazil; after 1940 Scandinavian, Portuguese and Italian stocks were obtained. An Italian firm near Turin was under German control until the expulsion of the Nazi armies, and the entire output was shipped to Germany. German progress in atomic bomb development was halted by the surrender, and as part of the industrial disarmament program for Germany, the pro-

duction of materials of primary importance in atomic research, such as beryllium, has been prohibited.

(13) *Uranium.*

Since September 1945 the USSR has been exploiting the uranium deposits of the Erzgebirge area on both sides of the Czechoslovakian border of Saxony. These workings are said to be shallow, consisting of crude, timber-lined shafts, from the base of which workers tunnel to follow the vein of ore. Necessary electrical energy is furnished by high tension installations removed to this area from other parts of the Soviet Zone. Some 100,000 Germans have been drafted from the Soviet Zone and forced to work in the mines under heavy guard. Soviet mining methods are primitive; working conditions are bad, and accidents are frequent. Old ore dumps are also being worked over for uranium, and the Soviet authorities are carrying away such zinc and cobalt ores as have been salvaged. The entire area is sealed off by Soviet military forces, and no one is allowed to enter or leave without special authorization from the administrative headquarters of the district at Aue. The cost of these mining operations is borne by the *Land* Government of Saxony.

According to Soviet reports, Erzgebirge uranium ore is of very high quality, believed to be the best in the world, and very easy to mine. German technical opinion has it, on the contrary, that the very fact that the USSR is mining pitchblende from such a poor source is an indication of a lack of better sources on which to concentrate. The yield of uranium ore from Saxony pitchblende deposits never amounted to more than 10 tons annually, the mines having been worked chiefly for cobalt and bismuth ores employed in the Saxony blue-dye industry. Total uranium reserves in the Erzgebirge area (German and Czech) are estimated to be about 600 tons U_3O_8 (uranium oxide). The USSR is believed to be exploiting this source at the rate of about 50 to 80 tons per year.

(14) *Pyrites.*

Sulphuric acid, the most important inorganic chemical used in industry, is prepared mainly from pyrites, of which Germany has

limited deposits in Westphalia and Bavaria. Before the war these furnished less than 40 percent of the annual domestic requirement of one million tons, the rest being imported chiefly from Norway and Spain. Sulphuric acid was produced in 66 plants located in three major areas; Westphalia, Bavaria, and Saxony. Much of the plant capacity was war damaged or dismantled, particularly in the Soviet Zone, where a shortage of sulphuric acid has been one of the principal limiting factors in the zonal economy. Bizonal production of pyrites in 1948 was 383,000 tons, while sulphuric acid production was 821,000 tons, or about 80 percent of what it was in 1936. The Soviet Zone produced 68,000 tons of pyrites in 1948 and imported 133,700 tons. Sulphuric acid production was 151,000 tons or about 50 percent of requirements.

(15) *Potash.*

Enormous reserves of potash, estimated at 20 billion tons, enabled Germany before the war to supply 65 percent of the world's total potash salts. Potash is prepared in various forms, the chloride and sulphate being used principally in the manufacture of fertilizers, the sulphate in the manufacture of glass, the carbonate in the manufacture of soap and glass, the chlorate in the manufacture of matches and explosives, the nitrate in the preparation of gunpowder, glass, enamels, and fertilizers, the cyanide in metallurgy, and caustic potash which is used in soapmaking, textile processes, and manufacture of potash chemicals. Mine owners at an early date combined to regulate production and maintain prices through a cartel known as the Deutsches Kalisyndikat, which confined operations to 30 or 40 of the lower cost mines on a quota basis and closed down the remaining 200 shafts, which were maintained, however, in a standby condition. Germany dominated world trade, except for the period of the first World War, through international cartel agreements to partition markets and stabilize prices. Loss of foreign markets in the second World War was offset by more intensive use of potash for domestic agricultural and industrial purposes. Wartime sales for the six-year 1939-44 period averaged 1.7 million tons K_2O

SECRET

annually, of which 70 percent went to agriculture, 3.5 percent to industry, and 18.5 percent for export, with a small amount left undistributed. Potash production in 1948 in the Bizone was 510,000 tons (K_2O content) and in the Soviet Zone 917,000 tons, of which 180,000 tons were taken for reparations and 238,000 tons for export.

(16) *Salt.*

The basic raw material of the important alkali chemicals is common salt, of which Germany ranked first for many years among world producers and exporters. The average prewar output was 3 million tons, of which 800,000 tons worth RM 10 million were exported. About 82 percent of the salt was disposed of through two syndicates, the larger of which was an association of big potash companies that also mined salt. The principal salt works in the US Zone total 10, in the UK Zone 28, in the Soviet Zone 23, and in the French Zone 6. Salt mining was resumed in the bizonal area in 1946 and quickly brought to prewar production levels.

Despite the abundance of alkali raw materials, the chemical industry operated at such a low level until 1948 that the production of caustic soda and soda ash was insufficient to meet demands. Consequently there was a serious shortage of soap, detergents, and other cleansing agents, while industries such as textiles, glass, paper, and rubber were also seriously affected. The largest caustic soda plant in Germany was at Bitterfeld, now in the Soviet Zone, which produced 32 percent of the prewar total. Dismantling and inadequate fuel supplies affected the capacity of this plant, and only 110,000 tons were manufactured in 1948. Output of caustic soda in western Germany reached 155,000 tons in 1948, an increase of 80 percent over the preceding year. Production of soda ash in 1936 was 726,000 tons, with the largest plant at Bernberg, now in the Soviet Zone, with an annual capacity of 410,000 tons. In 1948 Soviet Zone production was only 82,000 tons. Soda ash production in western Germany was 377,200 tons, or slightly in excess of the 1936 output for that area.

c. Industry.

The chaotic condition into which Germany was plunged by total defeat and the collapse of its industrial system is in sharp contrast to the stability, efficiency, and high degree of organization characteristic of German economy in the past. The disaster was the more spectacular because of the complexity of the preponderantly industrial economy which was geared to war production, but readjustment was not made less difficult by the disappearance of a sizable section (war goods) of an industrial complex that provided a livelihood for millions of Germans. Efforts of the western Allies to get Germany back on a production level approximating that of 1936 were handicapped by the fact that the entire economic structure was so badly warped and disturbed by the stresses of the intervening twelve years as to prevent its functioning on any but a low level, and then only with considerable outside assistance. The situation was further aggravated by the lack of structural economic unity resulting from the division of Germany into the four separate political and economic administrations, with a fortuitous distribution of resources and without an effective coordinating authority. Regional specialization and economic interdependency, carried to great lengths by the Nazis in order to maximize production, also accentuated the troubles arising from the separation of the country into sharply delineated zones of occupation. Moreover, the failure to effect currency reform during the period 1945 to June 1948, led to universal hoarding of goods, and thus the potential ability of Germany (all zones) to contribute to its own recovery was not realized.

Other important factors contributing to the continuance of the economic slump were the reparations, demilitarization, decartelization, and denazification programs of the Occupation Powers which: (1) closed and dismantled plants; (2) prohibited the production of war-potential materials formerly important to domestic industry and to the export market; (3) partially decentralized and destroyed long-established operational methods of whole industries; and (4) removed managerial talent

from the once closely integrated industrial machine.

Before the currency conversion in June 1948, the bizonal production level was only one-half of the estimated 1936 level. Between June 1948 and July 1949 the combination of currency conversion and Allied (chiefly US) aid brought production up 60 percent in Bizonia or to about 88 percent of Bizonia's estimated 1936 level.

The French Zone has a different economic structure and lacks industrial concentration. Agriculture is the principal occupation, the total value of agricultural products being about twice the total value of industrial products (\$50 million to \$28 million in June 1949). Agricultural yields in 1949 were only 70 percent of prewar, and great efforts have been required to improve the poor postwar food situation, in consequence of which the average consumer ration has been increased from 1,700 calories to 2,000 calories in the past year. Because of substantial imports of raw materials under the ECA program, there has been a marked increase in industrial activity. The official index of industrial production (1936=100) in the third quarter of 1949 was 85, compared to 81 in the second quarter, or a 70 percent increase over the corresponding period in 1948. Nevertheless, there is serious unemployment, arising mainly from lack of raw materials in several basic industries, and the financial picture is marred by the prospect of continuing budgetary deficits. Budgets are expected to be brought into better balance, however, by the release of counterpart funds for investment purposes. The 1949/50 investment program calls for an expenditure of DM 716 million, 41 percent of which is from counterpart funds and 20 percent from public subsidies.

The Soviet Zone possessed an industrial capacity at the end of the war sufficient for most requirements, but Soviet dismantling and reparations policies soon reduced it to a point below the minimum needs of the population. Later, the USSR reversed its policy of stripping the Soviet Zone of industrial capacity and built up basic industries in order to meet quotas established under the Two-Year Plan. Most of the production was sent to the USSR. The

Two-Year Plan, adopted in June 1948 set targets for 1949 and 1950 by which over-all production was to increase at the end of the period to 81 percent of that of 1936. This represented an increase of 20 percent over the 1948 level and 35 percent over 1945. Soviet Zone total production in 1947 was approximately RM 10 billion (based on 1944 prices); the 1948 level was to be increased 10 percent over this, but shortages and other bottlenecks prevented targets from being reached in all major fields except coal. Costs of production remain high, although productivity of labor has been increased by the introduction of the Hennecke and other labor speed-up or worker incentive systems. Because Soviet methods of computing values are open to question, and official quotas are frequently changed, fulfillment of the Two-Year Plan is problematical, although Soviet Zone production has improved in many respects since the lifting of the counterblockade in May 1949 and the restoration of western German sources of supply for critical items.

Outstanding individual industries are treated separately in the remainder of the section.

(1) *Electric Power.*

Prewar Germany was the most powerful industrial nation in Europe, ranking first in world production of brown coal, second in steel and electric power, and third in the output of hard coal. German industry was 85 percent dependent on electric power, and German power stations had a higher installed capacity and a higher output than those of any other European country. In normal times Germany produced annually about 24 billion kilowatt hours, but the Nazi rearmament program increased this to 40 billion kwh in 1936 and to 68 billion in 1943, which was the wartime peak production. A network of transmission lines, 18,000 miles in length, connected the generating plants in a vast grid, normally assuring supply of power to all industrial areas. Because of the enormous war potential of this industry, Germany's electrical generating capacity was drastically reduced under the Level of Industry Agreement. About 40 percent of electrical capacity was in industrial plants, many of which were in the war-potential class

and were scheduled for removal together with such generating plants as were considered surplus to revised industrial needs.

In 1948 electric power output was 18 billion kwh. Brown coal plants generate 41 percent of Germany's power output, hard coal plants 35 percent, and water power 14 percent, while gas, wood, and oil provide the rest. Practically all of Germany's hydro plants are located in the US Zone, which has little coal and must depend on coal imports from the Ruhr to operate its thermal stations. During the low hydro winter season, or in periods of prolonged drought, these thermal stations supply much of the zone's electrical power.

Of a total capacity of 10 million kilowatts of plant installed in what is now the bizonal area, only about 17 percent was available for service at the surrender. War damage, inadequate maintenance, shortage of fuel and essential replacements, and dispersal of personnel were the principal causes of the almost total breakdown of the once great German electric power system. Some of these difficulties have now been overcome, but shortages of fuel, transport, and materials still constitute serious handicaps to complete restoration of normal services for both industry and private consumers. Allocation of materials, like steel, cement, bricks, earthen conduits, and insulators were only 15 percent of requirements, while deliveries of coal generally did not exceed 60 percent of minimum needs. Nevertheless, by July 1947 nearly 46 percent of the plant capacity was back in operation. The rate of improvement has since become very slow owing to lack of repair materials.

The electrical supply situation is satisfactory for present needs. Replacement of worn or obsolete equipment and construction of additional power plants are delayed, however, by the lack of available capital. Consequently, generating capacity increased less than 10 percent in 1948 and 1949. In order to assure an equitable distribution of available supplies of current, rationing of electric power for domestic and commercial purposes is maintained, and a priority list was established for power supply. Executive control of the industry was transferred to the Germans on 1 January 1947, but responsibility for the determination of the

level of industry, reparations, and exports was retained by MG. Estimated power requirements over the next four years for a self-sustaining German economy are 16 million kilowatts of plant, or almost twice the amount of power now available. Although the electric power industry has high priority for investment purposes, the stringency of bank credit has interfered with plans for expanding plant capacity and building new power plants. As of June 1949, DM 110 million has been made available from GARIOA counterpart funds for a number of special power projects, but further grants are contingent upon German ability to provide funds from their own resources for this as well as for other investment needs.

Electric power output in the Soviet Zone increased 7.7 percent to 7.9 billion kwh in the first six months of 1949 over the last six months of 1948. This fell short of the planned quota for power production largely because of the embargo on spare parts and machinery from western Germany. With the restoration of normal sources of supply, power output is expected to improve somewhat. Power breakdowns are frequent, however, and the supply remains inadequate to industrial needs without further extension of plants and facilities, for which available funds are also short.

(2) *Electrical Equipment.*

Up to 1945, production, research, and development of German electrical equipment were in the hands of two large corporations—the Allgemeine Elektrizitäts Gesellschaft (AEG) and Siemens und Halske—which turned out equipment for generating, transmitting, distributing, and utilizing electrical energy principally for power, heating, and lighting, and manufactured radio and telephone equipment as well as aviation instruments, radar, and other electronic devices. While German progress in the field of electronics during the war did not match that of the Allies, German electronic scientists made substantial contributions to Nazi military power. Many of these developments would still constitute a menace to international peace and security in irresponsible or unfriendly hands. Production of German elec-

trical equipment was therefore limited by quadripartite agreement to 30-50 percent of prewar capacity; while scientific research was restricted to the exploration of new principles, and their application to military purposes was prohibited.

Since the electrical equipment industry was concentrated for the most part in Berlin,* it suffered heavy war damage and then fell into the hands of the USSR at the time of the occupation. The largest electronics plant, which was located in the UK sector of Berlin, was completely dismantled by the Soviet officials during their occupation of the city before the establishment of quadripartite control. Soviet economic penetration of this field has been greater than in any other, and Soviet AG's now control 80 percent of the industry. The USSR is steadily increasing the production of plants manufacturing electronics equipment and has been building up the huge Siemens works at Arnstadt in Thuringia, where a large number of German scientists and technicians have been assembled for research on electronic devices, particularly radio equipment for guided missiles and television, transmitters for remote control of aircraft. Estimated production of electrical equipment for industrial uses in the Soviet Zone is 67 percent of what it was before the war, while in the bizonal area (1948) it is 120 percent and in the French Zone 61 percent.

(3) *Iron and Steel.*

In prewar Germany the two great coal fields of the Ruhr and Saar in the west and Silesia in the east represented by far the principal German iron and steel producing areas. The Ruhr district, situated at the focal point of an excellent water transportation system, easily accessible to the great minette ore fields of Lorraine, and overlying enormous high-grade coal deposits, has for years been one of the greatest steel producing regions of the world. In 1936 the Ruhr accounted for 70 percent, the Saar for 12 percent, and all other

* The total value of all electrical equipment produced in 1936 was RM 1.5 billion, of which about one-half was produced in Berlin and one-third in the bizonal area.

areas including Silesia* for 18 percent of the total German steel output. This regional concentration was matched by the formation of a cartel of eight companies, controlling 95 percent of Ruhr steel production. During the war, the steel capacity available to Germany was doubled by the absorption of plants and mines in occupied countries.

German rearmament involved a tremendous program of economic self-sufficiency, particularly in steel. Since the German steel industry was concentrated close to the frontiers and thus vulnerable to air attack, the Reich in 1937 began mining domestic low-grade ores for new steel plants erected in the center of Germany. The Hermann Goering Works, a government corporation, was formed to mine ore and build and operate steel works and coke ovens. Salzgitter ores (± 30 percent Fe, high phosphorous) because of the difficulty in removing impurities, were uneconomical, but the Nazi self-sufficiency plan called for a production of 21 million tons, of which 15 million were to be treated in the Hermann Goering Works. This total was never attained, since the acquisition of the Lorraine ore fields in 1940 relieved Germany of the strained iron ore situation and gave a sufficient supply to meet all war purposes—60 million tons of 30 percent iron content from which 18 million tons of pig iron were made. The Germans then lost interest in the Salzgitter works, which at present consist of eight blast furnaces with an annual capacity of a million tons of pig, and six Bessemer converters with an annual capacity of nearly a million tons of steel.

At the close of the war, the Lorraine fields reverted to France, which also acquired the Saar, while Poland took Silesia. There was thus left to Germany the vast steel productive capacity in the Ruhr which had, however, limited ore resources of poor quality. The iron and steel industry had, moreover, come to a complete standstill. Considerable war damage had been sustained; the highly complicated industrial structure was badly disor-

* Silesia, together with northern, eastern, and central Germany—11.2 percent: Siegerland and Hesse Nassau—2.2 percent: Saxony—3.1 percent: Southern Germany and Bavarian Palatinate—1.9 percent. Total—18.6 percent.

ganized, and transportation facilities in the coal fields were totally disrupted. It was several months before production could be resumed. Meanwhile, agreement had been reached at Potsdam on the destruction of Germany's war potential, and steel was the yardstick against which German peacetime industrial productivity was to be measured. A substantial amount was essential for a reasonable recovery program, and under the March 1949 Prohibited and Restricted Industries Agreement, steel production in the bizonal area was set at 11.1 million tons.

Continued shortages of coal and electric power were serious handicaps to increased bizonal steel production, which in 1947 totalled only 2,460,000 tons and 5,750,000 tons in 1948. Transportation bottlenecks interfered with the movement of coal and ore to the plants and with the distribution of the semi-finished product. Labor was also a problem because of the absence of skilled workers, the general inefficiency resulting from the lack of food, and the large percentage of workers of advanced age. Substantial imports of Swedish iron ore and increased coal allocations, however, raised the output of bizonal German steel in the first half of 1949 to approximately 4.2 million tons; but further improvement is limited by the difficulties mentioned above. In line with US-UK policy, management of the industry in the Bizone is now very largely in German hands, but many steel works have been dismantled or allocated for dismantling on reparations account to the dismay of the Germans who oppose further progress in this direction because of the crippling effect at a time when extraordinary efforts are necessary to revive the entire German economy.

The French Zone is receiving imports of steel on reparations account from the bizonal area, and the French expect by 1951 to be producing about three times as much steel in their zone as the present 100,000-ton output which will still be hardly sufficient for local needs. Since German industries in the French Zone are geared for export to France, steel products have been given a low priority in contrast to other materials needed more urgently by the French economy. Security considerations have also influenced the French toward

keeping postwar German steel production at the lowest possible level, and they were reluctant to approve any advance in the Potsdam total of 5.8 million tons for Germany as a whole. It has been estimated that, on the basis of a population of 70 million, Germany will require 14 million tons of steel annually to meet the minimum needs of its economy, a figure which the French feel is at least 40 percent too high.

The most important deficit of Soviet Zone industry has been iron and steel, and it has held down replacements or renewals in all industrial fields. Before the war the Soviet Zone produced 2 million tons of steel annually; present production is 250,000 tons a year, and the minimum requirements are 1,200,000 tons. Soviet removals of steel-producing facilities have cut capacity to 27,000 tons a month. Imports from the western zones were inadequate, and these were absorbed to a great extent by the Soviet AG's, leaving the socialized industries of the *Laender* to operate on far less than the minimum requisite stocks. Following the blockade of Berlin, steel deliveries from the Ruhr ceased altogether, except for a certain amount of clandestine traffic, and the Soviet Zone had to depend upon imports from the USSR and the Satellites and work began on reconstruction of dismantling plants. Although Silesia, an important steel-producing area, has passed under the control of Poland, the USSR has had difficulty in obtaining steel from that source because Soviet Zone goods offered in exchange were unsatisfactory. The USSR wants a larger share of the iron and steel products of the Ruhr, and this need has been responsible for much Soviet propaganda in behalf of German political and economic unification. It has also inspired Soviet demands that German steel production be utilized entirely for the rehabilitation of Germany.

(4) *Machinery Industry.*

Under this heading are included all industrial machinery, electrical machinery and apparatus, prime movers, machine tools, construction and mining machinery, automotive equipment, locomotives, and ships. In pre-war years Germany's contribution to the

SECRET

world's supply of machinery was of great importance, in general paralleling that of Great Britain. Excluding Great Britain, Germany's production was greater than that of all the rest of Europe. The machinery industry, probably more than any other branch of German industry, made possible the supply of military matériel for Germany. During the war years production of machinery more than doubled in quantity while industry as a whole increased only about a third. Total production of machinery during the year 1938 was about 5 million metric tons. Production in the various zones was about as follows: Berlin, 14 percent; US and UK Zones, 47 percent; French Zone, 18 percent; and Soviet Zone and areas under Soviet control, 21 percent.

Machinery production capacity in Germany at the close of the war was far in excess of that of peacetime requirements and therefore many plants were scheduled for dismantling while production was limited by quadripartite agreement. Production of various categories of machinery, which has been increasing slowly since the cessation of hostilities, is currently about 40 percent of 1936.

During prewar years German exports of machinery varied between one-fourth and one-seventh of the quantity produced, and Germany supplied about 25 to 30 percent of world imports. Imports into Germany were comparatively very small. Categories of which large tonnages were exported included metal-working machine tools, textile and agricultural machinery, internal combustion engines, locomotives, steam turbines, electrical machinery, and apparatus. Germany supplied about 70 percent of European requirements of machine tools of which about 25 percent went to the USSR. Germany produced about 20 percent of the world supply of electrical goods, and German exports exceeded those of either the United States or the United Kingdom. In many other categories of machinery Germany was also the principal supplier to the European markets.

(5) *Rubber.*

Prewar Germany had the largest rubber industry in continental Europe, importing 100,000 tons of natural rubber in 1937, out of

which was manufactured a wide range of articles from hose and belting to rubber shoes and automobile tires. It not only sufficed for domestic needs but allowed for an export of about 6,000 tons. The chief center of the rubber industry was Hanover, now in the UK Zone, which is manufacturing tires at about 75 percent of prewar levels and exporting a small amount of processed rubber. Since no synthetic rubber is produced in the US Zone, tires have been imported from the US to keep motor vehicles operating at about one-third the prewar volume of traffic.

As late as 1937 the only German production of synthetic rubber was in an experimental plant at Leverkusen. Under the four-year plan of that year, however, construction of three large plants was commenced at Schkopau (near Leipzig), Hüls, and Ludwigshafen. Later a fourth plant at Auschwitz, Poland, was built but only partly operated before the end of the war. After further expansion, the plant at Schkopau, with an annual capacity of 72,000 metric tons, was the largest in Germany. The ultimate planned capacity of the four plants was 192,000 tons per year, or about twice Germany's prewar consumption of natural rubber. This large capacity was necessitated by cessation of imports and exhaustion of stocks of crude rubber. The bulk of the synthetic rubber output went to the Wehrmacht for tires.

Although the Potsdam Agreement provided for the elimination of all industrial facilities for the manufacture of synthetic rubber, the critical shortage of this material resulted in the temporary retention of three buna plants, which produced 45,000 tons of synthetic rubber in 1946. The Schkopau plant, now in the Soviet Zone, was operating in 1947 at a rate of about 42,000 tons per year, but partial dismantling reduced the capacity to 17,000 tons in 1948 and 27,000 tons (planned) for 1949. The only other German plant in operation was the one at Hüls in the British Zone, with a capacity of 10,000 tons per year. The latter ceased production in early 1948. The French closed the huge I. G. Farben buna factory at Ludwigshafen and made it available for reparations because the coal necessary to produce one ton of buna will produce

SECRET

II-17

five tons of nitrogenous fertilizers having five times the value. Except for a few elementary processes, manufacture of synthetic rubber was placed on the prohibited list in the 31 March 1949 agreement.

(6) *Chemicals.*

Germany possesses large natural reserves of most of the basic raw materials needed to produce the multitude of chemical products essential to a modern industrial economy. Coal, limestone, salt, potash, and wood are abundant within the country, but most of the sulphur and pyrites has to be imported.

Before the war Germany was the largest producer and second largest exporter of chemical nitrogen. The prewar output of about 700,000 tons per year was nearly one-third of the total world production, and of that quantity nearly 100,000 tons were exported. Present policy is to limit German production of nitrogen to its own needs, but because of coal shortages, war damage, and dismantled plants, the country is actually on an import basis.

Three-fourths of Germany's prewar nitrogen was produced by the Haber process in the form of synthetic ammonia. Since this is basic to the manufacture of high explosives, the restoration of German nitrogen manufacturing facilities has been retarded by Allied concern for the high war potential of the industry. Moreover, quadripartite policy with regard to Germany has been to limit its nitrogen production to its own consumption, thus further delaying reconstruction, since 80 percent of the nitrogen was produced in ten plants, all of which sustained severe war damage.

Eastern Germany has comparatively few fertilizer plants. Assuming full operation of these, annual nitrogen production in the Soviet Zone would be about 100,000 tons. Production capacity for phosphate fertilizers is 30,000 tons P_2O_5 (phosphoric acid) yearly, but actual production in 1946 was only 9,000 tons. Most Soviet Zone phosphate factories are not working because of the lack of raw phosphates. Imports are possible under barter trade agreements; even so, it would not suffice to meet the annual requirements of

50,000 tons P_2O_5 . Furthermore, the Soviets have taken considerable amounts of nitrogen and phosphate as reparations, leaving most of the fertilizer needs of their zone to be met from indigenous potash deposits.

Germany was the largest producer and exporter of dyes before the war. Prewar (1936) production of dyes and organic chemicals amounted to RM 499 million. The volume of exports averaged about 33,000 tons per year and ranged in value from RM 200 million to RM 336 million. The present limitation of RM 58 million on exports of dyes is not being attained owing to dislocations of the formerly highly integrated industry, shortages of raw materials, and lack of overseas sales organizations and credits.

The former large production and exports of pharmaceuticals, plastics, and synthetic organic chemicals has also almost disappeared because the erection of zonal barriers interrupted production processes in this formerly highly integrated industry, and, in addition, because of limitations on production imposed by the occupation authorities, 40 percent in the case of chemical raw materials, 80 percent in dyes and pharmaceuticals, and 70 percent in other chemical products. Export targets in chemicals are unlikely to be reached before 1949.

Possessing only small resources in petroleum, Germany built up a huge calcium carbide industry to provide acetylene as an alternate material for its synthetic rubber and plastics industries, and for certain other synthetic organic chemicals, all of which would be based on petroleum were it available in sufficient quantity, as well as to provide acetylene for its metal working industries. Of world production amounting to over 1,800,000 tons of calcium carbide in 1939, Germany produced about 1,000,000 tons. Dismantling of plants and shortages of coal and electricity had reduced the output in 1946 to 30,000 tons in the Soviet Zone and 304,000 tons in western Germany. By 1949 annual production had recovered in the Soviet Zone to 381,000 tons and in the Bizone to 385,000 tons.

Before the war, soda ash, caustic soda, sulphuric acid, and chlorine were also manufactured in quantities sufficient not only for do-

mestic needs but for a substantial export trade. Chemicals accounted for 7 percent of the total value of all products manufactured in Germany in 1936, or RM 2.2 billion, of which nearly 30 percent was exported. The industry was dominated by I. G. Farben, the largest chemical firm in the world, which produced 100 percent of Germany's wartime requirements of synthetic rubber, 98 percent of its dyestuffs, 75 percent of its chemical nitrogen, 61 percent of its calcium carbide, 55 percent of its pharmaceuticals, and 46 percent of its chlorine, as well as a great variety of other chemical products such as plastics and X-ray film. This vast concern ceased to exist after the surrender, and a large number of its plants were immediately dismantled or allocated for reparations. Although revival of the dyestuff industry has been marked since currency reform, production of dyestuffs in 1949 was only 25 percent of that in 1936. Production in 1949-50 is expected to rise from 11,500 tons to 25,000 tons, with exports increasing to 7,000 tons, of which about half will be shipped to the Soviet Zone.

In the chemical field, coal is the most important raw material, and the small allocation of coal to the German chemical industry was the main reason for its low production rate until late in 1948. There also have been difficulties in obtaining imported raw materials such as sulfur and pyrites, borax, iodine, camphor, vegetable drugs, and medicinal herbs. Furthermore, the various I. G. Farben plants,* although located in different parts of Germany, were nevertheless highly integrated, and consequently the necessary interchange of semi-finished products and intermediates between the Soviet Zone and the western zones, and vice versa, now so difficult, further complicated matters. Dismantling of plants, as well as decartelization and denazification procedures connected with the dissolution of I. G. Farben, have also retarded recovery in the chemical industry, which was

* Distribution of I. G. Farben properties is as follows: Soviet Zone 58.5 percent, Bizonia 21.5 percent, French Zone 20 percent. In the US Zone 77 of the 199 I. G. Farben installations have already been liquidated; in the Soviet Zone 86 out of 201, although all important plants are now Soviet-owned.

one of the most complex in Germany. Recovery in the US Zone, where 20 percent of the plants are located, was retarded by a total dependence upon the other zones for raw materials such as coal, pyrites, and synthetic ammonia. It was not until well into 1946 that the industry could be reactivated to any great extent. Fuel and power shortages were especially acute, the severe winter of 1946-47 causing a temporary shutdown of the entire chemical industry. In 1947 Bizone production was only 45 percent of the 1936 level, but with more coal and power available in 1948 it increased to 70 percent and in the first quarter of 1949 to 78 percent.

The greatest concentration of chemical plants occurs in the UK Zone, which has 35 percent of the total, but production in 1947 was only 40 percent of prewar levels. Chemical plants in the Soviet Zone, which has 28 percent of the total, suffered severely from war damage and then from sporadic Soviet dismantlings, so that chemical output has lagged considerably behind postwar objectives. The Soviet Zone industry has been further handicapped by the loss of raw materials attributable to the counterblockade of Berlin. Thousands of German chemists and technicians have also been taken to Russia to work on scientific projects and on erection and operation of plants for the USSR. The chemical industry in the French Zone, with 11 percent of the plants, has shown irregular production trends.

(7) *Textiles.*

Before the war (1937) Germany's consumption of all kinds of fibers was estimated at 969,000 tons, of which new and reclaimed domestic fibers accounted for 29 percent, imported raw cotton for 35 percent, and imports of wool, jute, flax, and hemp for the rest. Although the textile industry for the most part was not extensively damaged, recovery has been much slower than in other industrial fields because of the excessive dependence upon the import of raw materials such as cotton and wool, and the difficulty of obtaining chemicals for the manufacture of artificial fibers of the rayon type. The Level of Industry Plan allowed for the processing of 665,000

SECRET

tons of raw material (185,000 tons of artificial fiber and 480,000 tons of natural fiber), but production in 1948 had not reached one-half of this figure, except in synthetic fibers, which is now 50 percent above prewar levels. In order to revive the cotton spinning industry in the US Zone and to furnish employment for thousands of idle workers, the US Government has imported large quantities of raw cotton under the disease and unrest program.* Of the 152,000 bales of US cotton shipped to Germany in 1946, more than one-half was utilized for the processing of textiles for re-export to provide foreign exchange for payment of the cotton. The British have also imported raw wool and Egyptian and East Indian cotton into their zone under a similar program, and hemp has been obtained from Italy for the manufacture of rope and binder twine.

The German textile industry was centered in what is now the Soviet Zone. Because most of the spinning and weaving mills are located in the Soviet Zone, the west German textile industry is faced with a difficult equipment problem and is dependent upon imported machinery to effect an appreciable improvement over present production levels. While Soviet Zone machinery is sufficient to supply the needs of the population, lack of raw materials has forced the industry to run considerably below normal capacity. Soviet Zone raw cotton imports from the USSR dropped from 22,000 tons in 1947 to 7,000 tons in 1948, and only a slight increase in textile output was possible, mostly in artificial fibers. Actual production in 1949 is not expected to exceed 4 kilograms of material per head. Artificial fiber production in the Soviet Zone in 1948 was 40,000 tons, and the Two Year Plan calls for 90,000 tons by 1950, to achieve which will necessitate the building of several cellulose factories.

Under ECA it is planned to raise the consumption of textile raw materials in western Germany. In 1948 it amounted to 271,000 tons, or about 6.5 kg per head, and in 1949 it is expected to reach 409,000 tons, or 9.7 kg per head. Cost of these imports will rise from \$86 million to \$140 million. Artificial fiber

* See page II-30-31 on International Trade.

production in 1948 was approximately 100,000 tons. At present, the Bizone has 3.9 million running spindles, the French Zone 0.7 million, and the Soviet Zone about 2 million. In all zones obsolescence of equipment is a great handicap to further progress in the textile industry.

(8) *Other Industries.*

It would be hard to find an industry in Germany today which is not handicapped by shortages of material. Wood-working has been unable to procure the right type of lumber, glue, metal findings, or finishing materials. Furniture supplied for German civilian use was generally unfinished because of the shortage of shellac. Although Germany was a large manufacturer of leather goods, it imported a large part of the hides and skins prepared in tanneries. Leather output in 1948 was only 49 percent of prewar production, but the import of 63,000 tons of hides under the ECA program, in addition to the 20,000 tons from the domestic slaughter of cattle, permitted the manufacture of 2.7 million pairs of shoes monthly, which is still far short of reasonable requirements. The scarcity of pulpwood has handicapped the paper industry and restricted the publication of books, magazines, newspapers, and writing material. Ceramics has always been an important German industry, and an abundance of fine clays is available, but production until recently has been limited by the relatively large amount of coal required per unit of finished ware. The optical industry has been decentralized, and recovery has been retarded by the difficulties in the way of interzonal trade. Cameras are manufactured in the US Zone, but optical glass, lenses, and shutters must be obtained from the French and Soviet Zones. There is a ready international market for German optical products, and a percentage of cameras is set aside to pay for Germany's large import bill.

The need for building material was acute because of war damage. A system of licensing and control was instituted in order to assure an equitable distribution of such materials and to prevent their utilization for non-essential purposes. Cement production was limited

SECRET

to 8 million tons annually, but the rate of production was insufficient to reach this level. Glass and lumber were difficult to obtain and the production of bricks was not more than 10 percent of prewar capacity. Consequently, the production of building materials did not reach one-third of the prewar output. Following currency reform, however, employment increased in all the building material producing industries, and in the building industry itself. In October 1948, brick production was five times the average production in 1947, and cement production was 93 percent of the average production in 1936. Increased building costs and lack of investment capital have

hampered the reconstruction program, and housing conditions remain bad. Except for makeshift repairs, progress is retarded by the factors limiting German economic recovery in general.

d. Financial.

(1) *Banking.*

During the period when Germany was preparing for and prosecuting the last war, the German private banking system through purchase of government obligations supplied the bulk of credit needs of government agencies and financed construction in the war industries. The large German banks financed the

INDEX OF INDUSTRIAL PRODUCTION BY MAJOR INDUSTRY GROUPS

BIZONAL AREA

1936 = 100

Period	All Industry Groups	Coal	Building Materials	Chemicals	Paper and Pulp	Leather	Textiles	Sawmills	Electricity and Gas	Iron and Steel	Mining (excluding Coal)
1947											
1st Half	39	61	42	44	30	37	29	94	86	24	71
1947											
2nd Half	43	72	41	51	33	31	32	83	99	29	86
1948											
1st Qtr.	48	77	45	59	37	42	44	66	103	32	99
1948											
2nd Qtr.	51	74	59	54	41	36	41	53	110	30	93
1948											
3rd Qtr.	66	82	N.A.	66	60	56	59	60	115	44	111
1948											
4th Qtr.	76	86	N.A.	75	67	65	67	72	135	55	114
1949											
1st Qtr.	83	90	N.A.	83	81	71	81	81	142	60	121
1949											
2nd Qtr.	85	88	N.A.	85	84	73	88	82	131	60	124

SECRET

II-21

German cartels, syndicates, and trusts, and they also exercised, through interlocking directorates, considerable influence over the greater part of the German monopolistic groupings such as I. G. Farbenindustrie, Siemens & Halske, Krupp, Rhein-Metall-Borsig, and others. The Third Reich in turn exercised extremely wide powers in supervision of banking, concerning itself especially with the dismissal and appointment of the higher banking officials.

In its broad outlines this institutional control system had been established well before the advent of the Third Reich, but the degree of control over industry and the concentration of this control in the large Berlin banks (Grossbanken) were accentuated during the 1929-1939 period. Among some 650 commercial banks in Germany, the six Grossbanken (Deutsche Bank, Dresdner Bank, Commerz Bank, Berliner Handelsgesellschaft, Reichskreditgesellschaft, and Bank der Deutschen Arbeit) accounted for 55 percent of total assets and 59 percent of total deposits in 1938. The Reichsbank, with a network of over 500 branches, served as the main bank of note-issue and as the fiscal agent for the Reich.

At the beginning of the occupation existing economic controls and financial machinery in Germany was preserved and utilized, as far as was consistent with occupation policies. This included the maintenance by local authorities of such anti-inflationary measures and other economic controls as had been established by German law, and, in the western zones, the continued functioning of most of the banks. Branch banks were permitted to retain a reporting and policy relationship with main offices in their own *Laender*, but this relationship was not allowed to cross *Land* or zonal boundaries. The Reichsbank discontinued its former function of issuing bank notes and assumed the functions of a commercial bank. In addition, Military Government in the western zones employed the Reichsbank as its fiscal agent, as a supervisor of certain bank activities in each zone, and as a medium for transmitting and administering certain Military Government financial laws.

At Potsdam in 1945 the Occupying Powers agreed to eliminate excessive concentration of

power in the banking systems and to establish a uniform policy with regard to currency and banking. Implementation of the agreement on currency and banking, however, was delayed by lack of agreement on other essential matters. The Western Powers, therefore, followed an interim policy of liquidating the central boards of German banking monopolies and decentralizing them to the *Land* level. The USSR regarded these steps as partial measures and regarded the desire of the US, UK, and France to couple the elimination of excessive concentration of economic power in banking with the creation of central banking machinery as an attempt to delay a decision on German monopolies, in order to preserve them. Inability to reach agreement on such fundamental issues hampered the orderly extension of credit, contributed to inflation, and retarded economic recovery.

In the British Zone of Occupation the banking system was, with few exceptions, permitted to remain substantially unchanged pending quadripartite agreement on the future system to be adopted for the whole of Germany. Decentralization of banking without some form of centralized control was not, in the British view, a satisfactory solution of the problem and was not in accordance with accepted principles of economic unity. The USSR, on the other hand, closed all German banks in existence at the time of the capitulation, seized all assets, and stopped payment on old obligations of the German credit system. The USSR then established provincial, city, and regional banks of *Laender* and *Provinzen* Governments, employing new personnel and thereby solving the problem of denazification. In order to restore the economy, the newly established banks granted long-term credits for the revival of industry and the needs of agriculture. All stock exchange transactions are forbidden Soviet Zone banks, which are also not allowed to deal in securities issued before the capitulation of Germany.

In the French Zone of Occupation, German banks were authorized to continue functioning with the exception of the branches of the Bank der Deutschen Arbeit which had close affiliations with the Nazi Party. Branches of banks whose main offices were situated out-

side the French Zone had to sever their connections with the main offices. The Reichsbank established two offices, one in the North and one in the South, to supervise the Reichsbank's branches; and a supervisory board for the French Zone was set up at Speyer. Subsequently the French authorities cooperated with the German authorities in the implementation of measures which should result in a situation similar to that which exists in the US Zone: i.e., the liquidation of the Reichsbank, the creation of three *Laender* Central Banks, and the liquidation of the former branch bank system, which will be replaced by banks with branches exclusively in the *Land* in which their main office is located.

In November 1945 US Military Government proposed to German Land finance officials the establishment of a basic *Land* central banking organization which could be coordinated on a zonal basis and later integrated with any subsequent banking plan for Germany as a whole. The Germans were reluctant to cooperate in such a decentralization scheme, and little action was taken on the US proposals. Finally, in December 1946, legislation acceptable to US Military Government was enacted and became effective in all three *Laender* on 1 January 1947. When Bremen was established as the fourth *Land* in the US Zone on 21 January 1947, the Reichsbank district lines were adjusted to follow the political boundaries, and the new system was extended to include Bremen.

This law created a State Central Bank in each *Land* of the US Zone to take the place of former Reichsbank branches, and to function as bankers' banks similar to the US Federal Reserve Banks. In the absence of a uniform quadripartite agreement on currency and debt problems for Germany as a whole, the State Central Banks could not be granted the right of issue. For the same reason it was not possible to liquidate the Reichsbank entirely. The new State Central Banks were assigned the Reichsbank's current assets as well as the greater part of its liabilities. The Military Government appointed a Trustee in each *Land* to administer the Reichsbank's remaining assets and liabilities, the latter consisting mainly of accounts which had been blocked

for political reasons by the Military Government. To facilitate an eventual liquidation of the Reichsbank on a zonal basis, a General Trustee for the Reichsbank was also appointed for the entire US Zone.

The great commercial banks also resisted Military Government efforts to decentralize their economic power. Therefore, Military Government Law No. 57 was promulgated on 6 May 1947. It provided for the appointment by each *Land* government of an independent and disinterested custodian for the Deutsche Bank, Dresdner Bank, and Commerz Bank, to manage and administer the property of these banks within the respective states. The names of the banks were changed, and the influence of present officials and shareholders on the management was eliminated. Administrative regulations cut off the "giro system" (a system for the inter-bank transfer of funds) of the banks beyond state boundaries and forced all clearings of more than RM 100,000 to be carried out through the *Land* Central Bank system. Contrary to the fears of German officials, the law did not weaken public confidence in the banking system. There was no run on the banks, no increase in withdrawals, and no attempt to transfer funds to other zones.

The financial reforms imposed by the occupying powers on the western zones in June 1948 completely altered certain aspects of the banking situation in those areas.

The cancellation of the Reich debt and the conversion of other debts in June 1948 by the western Allies reduced deposit liabilities by 90 percent but wiped out entirely 80 to 90 percent of the assets of the commercial and savings banks. The structure of bank assets was then rebuilt. The State Central Banks credited the banks with amounts equal to 15 percent of their total (converted) deposit and savings accounts. The banks also were allotted "*Ausgleichsforderungen*" (claims against the State bearing 3 percent interest) to the extent that remaining assets proved insufficient to cover their liabilities including "appropriate capital" to be determined by the Bank Control Authority.

The banking system in the western zones was unified in June 1948 by the creation of

the Bank of German States, which acts as a depository of State Central Banks' required reserves. After the repudiation of Reich obligations, State Central Banks were credited with an amount equal to 30 percent of their (converted) deposit liabilities and their holdings of small notes and coins.

Banks in all three western zones were brought under reserve requirements similar to those already prevailing in the US Zone. Against current accounts State Central Banks are required to keep reserves of 12 to 30 percent with the Bank of German States, while for other banks (including Post Cheque Offices and Postal Savings Banks) reserve requirements are 8 to 20 percent. Reserve requirements against deposits and savings were established at 4 to 10 percent.

Until the June reforms, the banking structure in Berlin under occupation resembled that of the Soviet Zone in that all pre-occupation institutions (excepting the Volksbank, an urban credit cooperative) were closed and all pre-occupation bank accounts blocked. Only four banking institutions operated in the Soviet Sector, two of them municipally owned. These two, the Berliner Stadt Kontor and the Sparkasse der Stadt Berlin, were created after the Soviet occupation of the city and before quadripartite government was established. Only the Stadt Kontor was authorized to make loans at the beginning of the occupation, and these were limited to short-term credits. More recently this bank has been authorized to extend both municipal and private long-term credits, but it is not permitted to make loans to other banks. All interzonal cashless transfers in the Soviet Zone and Berlin are cleared through the Stadt Kontor, but only transfers in payment for goods may be made with the Soviet Zone and Berlin. Of the two other financial institutions, the Post-scheckamt provides only postal giro or clearing services, while the Volksbank, which was authorized to reopen in December 1945, supplies the normal services of an urban cooperative system.

In the Soviet sector following currency reform the Deutsche Emissions- und Giro-bank was converted on 20 July 1948 into the Deutsche Notenbank (German Currency

Bank), which was given the right to issue currency and to perform commercial banking functions. All bank deposits, which had been blocked up to 60 percent after currency reforms were transferred to the Notenbank to provide it with loans funds and to insure centralized control over all commercial banking in the Zone. The chief customers of the Notenbank are the Soviet Zone central administrative organizations, the Soviet corporations (AG's), and the Soviet commercial companies. An additional function of the Notenbank is the financing of reparations from current production and other exclusively Soviet interests in eastern Germany. Other firms must obtain operating funds either from their Soviet enterprises or from cooperatives. The Investment Bank under the Control of the DWK remains the main agency for granting long-term credit, and as such exercises a powerful influence in shaping the economic development of the zone in conformity with Communist purposes. The Garantie und Kreditbank is the dominant institution controlling foreign trade and foreign exchange transactions in the Soviet Zone.

(2) *Currency.*

The printing and issue of Reichsmark currency which ceased during the last weeks of the war was not resumed. At the end of the war there were about 60 billion Reichsmarks and about 10 billion (some estimates run as high as 20 billion) Occupation Marks, compared to RM 10.5 billion in 1938, in circulation in Germany. Most of the Occupation Marks represented an excess issued by the USSR early in 1945 under an agreement among the Occupying Powers to use a single form of occupation currency, the Allied Military Mark. This large supply of money, coupled with a low level of production of goods, resulted in an increasing tendency among the German population to refuse the Reichsmark in business transactions and the payment of debt and to demand other forms of compensation. By 1946 the Reichsmark would purchase rationed goods, but little else.

Since currency reform was basic to the solution of Germany's economic ills, the occupying powers sought agreement on concerted

measures for all four zones. The Allied Control Council agreed on the issuance of a single currency, for the whole of Germany, to be known as the Deutsche Mark. Adoption of the plan on a quadripartite basis was blocked, however, by the failure of the US and Soviet delegates in ACC to agree on a site for printing the new currency. Whereas the US insisted on having it printed in Berlin under close quadripartite supervision, the USSR wanted part of the total amount printed at Leipzig, an arrangement which the US believed would result in further unregulated issuances of currency detrimental not only to the German economy but to the US financial position in Germany.

The apparent unwillingness of Soviet authorities to cooperate in reviving the German economy and the pressing necessity of such a revival in the western zones to the success of the Marshall Plan finally impelled the western Allies to break the currency reform impasse. The western Military Government authorities, therefore, proceeded jointly in the three western zones* with a currency conversion and related financial reforms by three laws promulgated within one week, that ending 26 June 1948.

The first law introduced a new Deutsche Mark and provided for the conversion of the old coins and currency—Reichsmarks, Rentenmarks, and Allied Military Government notes—into "*Deutsche Marks*" at the rate of 10 RM to 1 DM. The second law established the Bank of the German States as the Bank of Issue and introduced reserve requirements for all banks. The third, or Conversion Law, announced the all-important conversion rate of 10 to 1 for bank accounts, private liabilities of all kinds, insurance policies, and the like. A comprehensive tax reform was also introduced. The thorny question of the disposition of obligations of the old Reich was settled by voiding them. Fiscal and banking features of the reforms are discussed under appropriate headings elsewhere.

* Reforms instituted in the western sectors of Berlin are treated above: see page I-16-17. Discussion of the currency reform in the Soviet Zone is found on page II-26.

Other important features of the currency reform may be summarized as follows. All old currency was turned in. Each inhabitant of the western zones was allowed to exchange 60 RM for 60 DM, and business enterprises were granted a special allowance of 60 DM for each employee in order to provide cash for immediate needs. (Subsequently bank accounts were debited 540 RM, the difference between the 60 RM surrendered and the 600 RM required for exchange of 60 DM.) Reichsmarks surrendered in excess of 60 RM were credited to bank accounts. These accounts (which included both surrendered cash and old credit balances on deposit) were divided equally into two types—"Free" and "Fixed" accounts. Their RM value was converted to DM value at a rate of 10 to 1. The "Free" accounts were made immediately available for withdrawals; the "Fixed" accounts were blocked until October 1948. At that time it was decided (over the protests of German financial authorities) to unblock 20 percent of each of the "Fixed" accounts, to destroy 70 percent, and temporarily to continue blocking the remaining 10 percent.

Salaries and wages were made payable in DM on the old RM scale (and wage increases up to 15 percent were authorized). This stipulation put businesses under pressure to sell hoarded stocks of goods in order to maintain a liquid position. The bank accounts of public authorities were rendered void; public expenditures were to be met out of current receipts. Prices of a wide range of consumer goods were decontrolled, with the exception of most foodstuffs and raw materials. Clothes rationing was also reintroduced.

The imposition of these reforms, was damaging to certain laboring and business groups. The reforms were, however, a necessary prelude to recovery as soon became manifest in the disappearance of black markets, the re-appearance of goods in shops and markets, a decline in unemployment, and a sharp increase in production. It was plain that the western Allies had planned for an eventual level of Deutsche Mark prices much higher than the prewar Reichsmark price level, since the present note issue limit is equivalent to DM 220 per capita against RM 86 per

capita in 1933. The increase would seem to be justified, however, both because world prices have increased considerably in the intervening period and because the German people apparently want to hold a large proportion of their assets in liquid form. Western Allies were concerned, however, by the possibility that the October release of 20 percent of the blocked accounts would set off a wave of price increases, and further the disparity between wages and prices. Should such a development be attended by renewed hoarding and labor disturbance, the consequent decline in production would tend to cancel the economic improvement brought about by the June 1948 reforms.

Soviet authorities were quick to counter the conversion in the western zones with a currency reform applicable to the Soviet Zone, including the Soviet Sector of Berlin. The conversion in the Soviet Zone was remarkable in that although low income groups in the zone received somewhat more favorable treatment by its terms than these groups received in the western zones, publicly owned enterprises and Soviet owned corporations were excluded from conversion requirements. Thus the reduction in the volume of currency was not so drastic as in the western zones.

The first 70 RM turned in by an individual were converted at a 1 to 1 ratio, without being debited to bank accounts. A ratio of 10 to 1 was established for the conversion of the next RM 5,000. For sums in excess of RM 5,000 no conversion was permitted individuals until investigation proved that the sums had been lawfully acquired. Cash holdings of firms, organizations, and institutions were exchanged at 10 to 1. Current accounts were converted at 10 to 1 for the first RM 5,000; amounts in excess of RM 5,000 were subject to proof of legitimacy. A 1 to 1 conversion rate was allowed for funds of public authorities and accounts of publicly-owned enterprises. For funds of the State-owned insurance corporations the conversion rate was 5 to 1, and of the social insurance institutes was 2 to 1. Earnings of war profiteers, profits derived from speculations, and ac-

counts of war and Fascist criminals were confiscated.

Savings deposits received special treatment. The conversion rate was 1 to 1 for deposits up to RM 100; 5 to 1 up to RM 1,000; and 10 to 1 from RM 1,001 to 5,000. Accounts in excess of 5,000 were subject to proof of legitimacy.

Debentures were issued in place of current reserves and savings deposits established before 9 May 1945 at a conversion rate of 10 to 1, provided that balances in excess of RM 3,000 could be proved legitimate.

No change was authorized in wages, salaries, and taxes. The reform did not affect internal and foreign public debts, and the liabilities of closed banks were also unaffected.

The differences in the financial reforms of the western zones and of the Soviet Zone have brought about a difficult financial situation in Berlin, where dual currency and banking systems exist as well as separate budgets for the German municipal governments of the eastern and western sectors. The failure (to date) of negotiators of the Western Powers and the USSR to reach agreement on financial matters in Berlin, however, is symptomatic of the continuing basic disagreement on the control of Germany and Germany's future role in Europe.

(3) *Government Finance.*

In the sphere of financial policy in Germany the Allied Control Authority was faced with the problem of reorganizing the revenues and expenditures of German budgets to insure not only the reconstruction of a peaceful economy but also the fulfillment of reparation claims, occupation costs, and other obligations imposed on Germany under the terms of the surrender.

During the war and the years immediately preceding it, the German budgets were adjusted to satisfy the military program of the Reich. Expenditures for the period of the war were approximately 650 billion Reichsmarks, of which 600 billion were devoted directly or indirectly to war expenses. Of this expenditure not more than one-third was covered by tax and other ordinary forms of revenue. The greater part of the remainder was

financed by an issue of public debt of approximately 400 billion Reichsmarks, equal to 31 times the indebtedness at the beginning of the Nazi regime and five times the prewar national income of Germany. Of this issue only a small part was sold to the public, the bulk being distributed to various credit institutions. The Reich indebtedness was further expanded as a result of war damages and compensation for other war losses until the total Reich debt was around RM 900 billion. At the end of the war there was little prospect of this debt being serviced. During the first three years of occupation all national debt service charges were omitted from government budgets. Upon repudiation of such debts in June 1948 all service charges on Reich debt were eliminated in western zonal governments for the future.

Following the surrender of Germany in May 1945, regular governmental expenditures dropped sharply. As has been stated, payments of interest on the Reich public debt were suspended, and those on the debt of lower governmental units were generally discontinued. Outlays for war production, as well as for maintenance of the Military Services, were terminated; payments on account of war damage claims, pensions, relief grants, and other war expenditures were either eliminated or severely restricted by Military Government. Officials and employees of the former Reich who were not required for essential functions taken over by the *Laender* were removed from the payrolls; and certain functions, such as the political police, were eliminated. On the other hand, large extraordinary governmental expenditures occurred. They included occupation costs, care of displaced persons, and general relief. Total extraordinary expenditures (occupation costs, expenditures for displaced persons, refugees and expellees, prisoners of war, interment camps, port costs in Bremen, contribution to *Land* Central Banks, and the like) have constituted over a third of the total expenditures of *Laender* governments.

In order to provide the funds required for the fiscal operations of the *Laender* governments, a reorganization of the German tax system was necessary. Formerly, the prin-

cipal revenue producing taxes were levied by the Reich but were collected by the States, the Reich returning a share to the States, which in turn passed on a proportion to the Communes. Yearly budgets were approved by *Laender* governments but had to be submitted to the Reich Finance Minister whose final approval was essential in the case of long-term loans, utilization of reserves, and the acquisition, sale or mortgage of estate property of the province. Thus the Reich tax administration was highly decentralized for operating purposes but closely controlled as to policy by central offices. After the capitulation, the former Reich financial mechanism ceased to function, and the Reich budget ceased to exist.

One of the first tasks confronting the occupying forces, therefore, was to devise interim expedients for utilizing the decentralized remnants of the former administrative machinery. At an early date, the tax powers of the former Reich were vested in the individual *Laender*, so that existing tax offices continued to collect Reich taxes under the jurisdiction of separate *Land* Ministries of Finance. These revenues were made available for local as well as *Land* purposes. At the same time all special tax favors granted the Nazis and their followers in existing legislation were removed, and discriminatory taxes against Jews and other racial minorities abolished.

The low level of production, trade, and income of the immediate postwar period resulted in a precipitant drop of 60 percent in *Land* tax collections for the fiscal year 1945 in the US Zone. At the same time, in spite of the sharp reduction in incomes, inflationary pressures created by the years of deficit war-financing remained as a threat to the already shattered economy. To reduce the dangers of inflation, as well as to provide larger government revenues to meet rising costs, the ACC in February, May, and June 1946 revised and drastically increased the rate schedules for most types of taxes.

As a result of these measures, German tax collections in all zones, which averaged RM 10.1 billion annually in the years 1933-1937, amounted to RM 21 billion during the fiscal year 1946-47. Compared to RM 1.8 billion collected in 1945 in the four *Laender* of the US

Zone, collection in 1946-47 amounted to RM 4.6 billion, of which 78 percent was income, property and transportation taxes, and 22 percent customs and excises. Tax collections in the combined US-UK Zones for 1946-47 were RM 10.8 billion as against RM 5.7 billion for the previous year, an increase of 90 percent.

Despite heavy expenditures requirements including substantial occupation costs, and in contrast with virtually all neighboring countries, budgets of all western zones were brought approximately into balance by 1947. This feat was accomplished only by omission of all national debt-service charges from the budgets. The repudiation of the Reich debt in June 1948 relieved western zonal governments of all such charges in the future. The chief inflationary pressure prior to currency reform came from the excessive volume of currency and deposits created during the war and not from the current spending of German governments. While tax increases have been heavy, particularly in view of low production, only limited recognition was given in German circles to the fact that German taxes during the war were 30 percent lower than those of most countries, and that only the incidence of these burdens and their allocation among social and economic groups can be altered.

The tax situation of the *Laender* in the western zones was drastically altered by the financial reforms of June 1948. Under the new system, income and wage taxes were reduced about one-half, and the tobacco tax was reduced about one-third. Inheritance and corporation taxes were altered without a probable change in yields, and a capital transaction tax was re-imposed. A heavy coffee tax was also imposed. In addition, the *Laender* were authorized to levy additional taxes, including surcharges on the scheduled taxes. On balance the new system will result in a shift to heavier dependence upon indirect, regressive types of taxes and to less dependence upon income taxes.

Although currency reform accomplished most of its major objectives, one of the chief remaining threats to financial stability is unbalanced public budgets. Deficit public spending has resulted in a net addition to the money supply already sufficiently large to exert con-

siderable inflationary pressure on the economy. Public budgets at all levels are experiencing difficulty in adjusting their expenditures to reduced revenues. The budget of the Bizonal Economic Administration for the fiscal year 1948-49 was balanced at 408 million marks, a 100 million mark increase over the previous fiscal year, but almost 200 million marks lower than the precurrency reform estimates for the current fiscal year. Although the 1949-50 budget is balanced, it is by no means certain that expenditures will be covered. The bizonal budget depends for its revenues mainly on the statutory contributions of the German Post (100 million marks) and the German Railways (174 million marks). The financial condition of these agencies is such that considerable difficulty will be experienced in making these funds available. In addition, the Bizonal Economic Administration is required to provide funds to finance the support of Berlin. The development of the *Laender* budgets since currency reform has shown that deficits of dangerous magnitude must be expected in a number of *Laender* unless drastic measures are applied. Cash balances have dropped by almost one-half, and tax revenues have shrunk rapidly, while payrolls have continued to expand. *Laender* encountering the most troubles are those such as Schleswig Holstein which bear the brunt of heavy occupation costs or of large expenses for refugees and evacuees. No action has been taken on the problem of equalizing such burdens.

By the spring of 1949 the progress of western German recovery showed signs of slowing down. Further improvement appeared to be hampered by lack of capital for long-term investment. The shortage of loan funds forced the banks into a cautious lending policy, interest rates were high, and the principal method of financing the needs of industrial and business enterprises was the unorthodox one of discounting three month trade bills. Despite Military Government pressure to develop a long-term investment program, little was accomplished because of inadequate savings and German disinclination to provide capital from German sources by taxation. To control deflationary tendencies in an economy (which is potentially inflationary) and to remove

some of the more dangerous production bottlenecks, Military Government established a credit of one billion west marks for emergency investment purposes, of which DM 220 million were earmarked for the expansion of the electric power plant program in order to reduce the bizonal power shortage. Military Government efforts also resulted in the passage by the Bizonal Economic Council on 20 April 1949 of an acceptable tax reform law retroactive 1 January 1949, devised to encourage both saving and investment. Nevertheless, the Germans continued to rely heavily on the future availability of foreign capital plus ECA counterpart funds and to minimize both the necessity and possibility of developing internal sources of investment funds. The German authorities were advised, however, that Military Government would not permit more than DM 2 billion to be drawn from counterpart funds for capital investment purposes and that the remaining DM 6 billion required for the 1949/50 program must come from public budgets and private sources.

In the Soviet Zone a zonal budget which has replaced the five *Laender* budgets is prepared under the close supervision and direction of the SMA. Income generally exceeds expenditures by a considerable amount. About half the current revenue is transferred to the German Central Finance Administration which provides a great variety of subsidies for the support of the zonal economy. It covers the deficits incurred by the coal mining and other industries, maintains a ceiling on prices, primarily for state-owned enterprises, prevents price increases for foodstuffs, liquidates the debts of expropriated concerns, finances reparations and export deliveries, and provides for the reconstruction of factories. All this requires a very heavy tax levy. The five *Laender* budgets for the fiscal year 1947-48 anticipated a total revenue of RM 8.5 billion with total expenditures placed at RM 8.3 billion. Actual collection amounted to RM 8.9 billion, principally in consumers' taxes which accounted for 46 percent of total revenues compared to 17 percent from this source in the UK Zone and 22 percent in the US Zone. The zonal budget for 1948/49 was approximately the same as for the preceding fiscal year, but tax collections

were RM 9.2 billion, or nearly 5 percent greater than in 1947. This would indicate a general increase in industrial production, especially as the turnover tax remained at an occupation period high, and reflects Soviet efforts to obtain maximum benefits from the zonal economy. It is doubtful, however, if this high tax rate can be maintained in 1949 in face of the production difficulties occasioned by the cessation of East-West trade following the imposition of the counterblockade in July 1948 and the financial difficulties caused by currency reform.

(4) *Reparations.*

The plan for reparations and level of post-war German economy adopted by the Allied Control Council in March 1946 was based on the Potsdam Agreement providing for German unity. The objectives of the plan were:

- (a) the elimination of the German industrial war potential;
- (b) the provision of reparations out of Germany's capital equipment for victims of Nazi aggression; and yet to
- (c) leave within Germany necessary plants and equipment to permit rebuilding of a viable, peaceful economy.

Because of Soviet intransigence little could be accomplished toward the objectives of the plan on a quadripartite level; therefore, the US and UK Zones of Germany were fused for economic purposes in January 1947. On the basis of industrial capacity scheduled to be retained under the Reparations Plan of March 1946, it soon became evident that the Bizonal area could not become self-sustaining, and in August 1947 the US and UK announced a revised level of industry for their zones of Germany, to approximate the level of industry prevailing in 1936, an increase of about one-third over the level contemplated in the original plan. In October 1947, the US and UK announced a list of 683 plants and part plants which were surplus to the new industry level and therefore available for reparations.

Reports of US Congressional Committees on the desperate situation of the German economy and pending legislation for the European Recovery Program brought increased agitation for cessation of reparations deliveries. It

was feared that the elimination through reparations of equipment which could be of help to the economic recovery of Germany would undermine the recovery program. Further, the US Congress objected to reparation deliveries to the USSR of materials which assist in the development of war power.

Before its 1947 Christmas recess the Congress passed the Foreign Aid Bill without specific restrictions in the matter of reparations, but made clear that the question of plant removals would receive detailed consideration by the next session of Congress.

The breakdown of the Allied Control Council following the walk-out of the USSR in March 1948 eliminated all possibility of four-power agreement on reparations matters. In April 1948 all deliveries from the US Zone to the East were halted "pending clarification of certain issues." At the same time, the US Technical Mission, under cover of secrecy, went into western Germany to study dismantling and the reparations program as they related to European Economic Recovery and the development of the Soviet war potential.

After ERP came into being, the US took the position that it was desirable to re-examine certain portions of the reparation lists with a view to determining the extent to which some of the plants might better serve the needs of European recovery if left in Germany than if removed and re-erected elsewhere. A survey of the situation was consequently undertaken late in 1948 by a committee of US steel experts; meantime dismantling on a limited scale went forward in the French and US Zones.

The report of the Humphrey Committee became the basis of negotiations at London early in 1949 that resulted in the signing of an agreement on 31 March on Prohibited and Restricted Industries, under which it was agreed to retain in the German economy all but 9 of the 168 plants scheduled for dismantling but listed by the Committee as essential to the recovery program. Restrictions were placed on the production of ball bearings, primary aluminum, chlorine, and a few other products. Steel capacity was limited to 11.1 million tons per year, and all remaining capacity was to be allocated to IARA for distribution among its

members. The synthetic rubber and fuel industries were placed on the prohibited list, and all except a few of their installations ordered removed. Seven shipyards were also ordered removed, and German shipbuilding was restricted to the capacity that remained, subject to certain other limitations on the possible size and speed of the vessels to be built. The provisions are subject to review not later than 1952.

e. International Trade.

Before World War II a large foreign trade was one of the contributing factors to Germany's position as the most industrially powerful nation in continental Europe. Conversely, German exports and imports were of great importance to European economy. In 1936, for example, 11.4 percent of Germany's total industrial production was exported. Of total industrial exports, 75 percent came from the mining, metal-working, and chemical industries and only 25 percent from consumers' goods industries. About 16 percent of the total value of hard-coal output was exported, 23 percent of the machine tools, and about 25 percent of the output of chemicals. At the same time Germany was dependent on imports for a large part of its food supply and industrial raw material needs.

In normal prewar times Germany was one of the two major links (the other being the UK) in the pattern of trade and trade settlements in Europe. In contrast to the UK, which had a large import surplus from Europe, Germany had a large surplus of exports to most other European countries. These countries were able to settle their German accounts with pounds sterling, receipt of which allowed Germany, in turn, to maintain a large surplus of imports from overseas suppliers of raw materials. The world-wide depression and the Nazi rearmament program altered this situation, and Germany developed a system of administrative controls involving barter trade, import-export quotas, multiple exchange rates, and export subsidies, for the purpose of attaining planned trade objectives. Owing to the shortage of foreign exchange, the import program was restricted to essential foodstuffs, raw materials, and other com-

modities essential to the military program. Total value of foreign trade declined from RM 27 billion in 1929 to RM 10.6 billion in 1938. Although the major part of Germany's exports went to the industrialized countries of Europe, Germany was the most important source of supply of manufactured goods for central and eastern European countries.

From the outset of the postwar period the revival of the foreign trade of Germany, so essential to the recovery and maintenance of internal economic stability, encountered great difficulties. The business community of no other European country was so completely isolated from the rest of the world, and no other country dependent upon foreign markets and supplies was equally handicapped in its facilities for carrying on foreign trade. The whole complicated institutional system required for sales abroad disappeared to be replaced by the cumbersome postwar foreign trade administration, over which a series of Military Government controls was imposed. This change further retarded trade recovery.

The Potsdam agreement provided for the creation of a central German administrative department for foreign trade. On 15 August 1945, a quadripartite Export-Import Sub-Committee was created, and an interim plan was developed in line with the provision of the Potsdam agreement that imports were to be restricted to goods necessary for minimum standards of consumption and production. Implementation of the plan was, however, left to the respective zone commanders.

The difficulties of quadripartite discussion finally led the Military Governments to foreign trade planning on a unilateral basis. During 1946 it became apparent that neither the US nor the UK Zone would become self-sustaining without a concerted effort to stimulate exports and simplify trade procedures. The Byrnes-Bevin agreement, dated 4 December 1946, provided for the economic integration of the US and UK Zones (the French and Soviet Governments having declined to participate) and for the creation by 1 January 1947 of a Joint Export-Import Agency (JEIA). This agency was charged with the collection of proceeds from export sales and the billing and accounting for all exports and imports,

in addition to planning the foreign trade program and supervision of trade relations with other countries. Finally, on 18 October 1948, the French Military Governor signed an agreement with the US and British Military Governors, to merge the foreign trade of the US, British, and French Zones of Occupation in Germany.

(1) *Bizone.*

Before the war, steel, metal goods, machinery, and chemicals constituted about two-thirds of the exports of the Bizone. Because of restrictions on war-potential capacity and shortages of power, manpower, and transport, such formerly important export items as machine tools, roller bearings, and heavy machinery generally have not been produced in large quantities. Hence, the character of the Bizone's postwar exports, limited as they have been chiefly to raw materials, has thus far borne little resemblance to the prewar pattern.

The European Recovery Program assumes the ultimate achievement of an export surplus to the other participating countries. The extent of the increase in importance of manufactured goods in the export program is evident: "coal, timber, and scrap" declines from 57 percent of total exports in 1948-49 to 31 percent in 1951-52, the compensating increase being in the manufacturing fields, chiefly machinery and equipment. The Bizone is expected to supply the need in ERP countries for a wide range of replacement and maintenance parts for German machinery, especially agricultural, food-processing, and mining machinery.

The extent of the progress necessary if the Bizone is to balance its foreign payments accounts by 1952 without extraordinary outside assistance is indicated in the following figures. For the fiscal year 1948-49 the Bizone relied upon outside assistance to cover a current account deficit in its balance of payments of \$1,041 million, of which \$404 million represented ECA grants and the balance the occupying powers' (chiefly US) "GARIOA" appropriations (for the prevention of "disease and unrest") for food, fertilizer, seeds, and petroleum products. ECA estimates for 1949-50 a

SECRET

current account deficit of \$892.5 million of which about \$476 million is to be met by GARIOA appropriations and \$302.5 million by ECA grants.

On 1 May 1948 a long step was taken toward normal foreign trade transactions. On that date a conversion rate of 1 RM=30 cents was established for German currency, consonant with the currency reform effected internally shortly thereafter. Under the early quadripartite agreement to maintain the 1936 price freeze instituted by Hitler, the German price structure had come to bear no reasonable relation to world market prices. Since JEIA had complete control of foreign trade, the problem of pricing exports was handled by administrative decision. German firms offering to JEIA goods for export were paid in German currency at the domestic ceiling price and JEIA sold the goods abroad for dollars at as favorable a price as possible. This arrangement discouraged exports in two ways: (1) there was no price inducement for Germans to offer goods for export; and (2) most potential foreign buyers, being short of dollars, tended to limit their purchases from the Bizone. The pricing of imports was handled in a similar way. JEIA paid the world market price in dollars and charged the German importer the internal ceiling price in German currency. Since the new conversion rate was established in May 1948 the isolation of German internal prices from world prices has largely ended. Since 1 May 1948, the conversion rate of one mark to 30 cents has applied to all exports except coal and to all imports except staple foodstuffs. In the case of exports, however, if the price obtained and converted into marks at the 30-cent rate fell short of the domestic ceiling prices, the difference was paid by JEIA as a subsidy to the exporter.

On 1 December 1948, JEIA controls were reduced to a minimum under new regulations permitting German businessmen to deal directly with foreign buyers or sellers without going through JEIA. Although considerable leakage of foreign exchange is believed to have resulted from the relaxation of JEIA controls, there is no doubt as to the stimulating effect of the simplified procedure on the Bizone's export trade. With the establishment of the

west German government, trade control and export license functions were transferred to agencies of the federal and *Laender* governments under the nominal supervision of the High Commissioners.

Reflecting the rapid industrial progress of the Bizone since June 1948, and also the improved export procedures, exports increased from \$91 million in the first quarter of 1948, to \$265.8 million in the first quarter of 1949. Of total imports of \$387 million during the first three months of 1949, \$142.5 million were financed with the proceeds of exports, \$135.3 million by US/UK appropriations, \$109 million by ECA funds.

(2) *French Zone.*

The present French Zone is poor in basic raw materials and resources as compared to the Bizone. Before the war the area now comprising the French Zone paid for needed imports of grain, coal, steel, cotton, hides, and various other industrial raw materials by exporting agricultural products (wine, tobacco, meat, potatoes, fresh fruit, and vegetables) and manufactured goods (chemicals, shoes, textiles, and time pieces). The area also had a large timber industry, and exported lumber and wood products. Trade was chiefly with the area now included in the Bizone.

Although the postwar agriculture and industry of the French Zone suffered from direct war damage and reparations, one of the chief causes of its stagnation was the disruption of its trade and the consequent lack of raw materials.

Since the war, more than half the total exports have gone to France, whose needs have been the paramount consideration in determining the character of this trade. In return for exports of lumber needed for French reconstruction, and some food, needed in the Saar, the Zone has received Saar coal and food imports from the US, paid for by France. Food, coal, and potash fertilizer have been obtained from the Bizone in return for lumber, small amounts of meat and tobacco, potatoes, and nitrogen fertilizer. Nevertheless, food imports have been barely sufficient to ward off starvation, and coal has had to be diverted to non-industrial uses.

SECRET

In contrast to the Bizone, the French Zone did not have the benefit of substantial assistance from the occupying power, and has suffered in addition from occupation troops "living off the land." In 1946, total exports from the French Zone were \$60 million, three times the value of exports from the US Zone over a longer period of time. All but a small proportion, probably less than 20 percent, of this trade went to France. Certain plants worked exclusively for the so-called export program and were accorded preferential treatment in the supply of power, coal, and raw materials as well as in the allocation of cigarettes and food. Exports continued to increase and reached \$106 million in 1947, of which \$88 million went to France. The largest zonal exports to France consisted of lumber and lumber products, and constituted 38 percent of the total. Imports amounted to \$13 million, of which 37 percent came from the US, mostly in foodstuffs. Rising world prices for imports turned this favorable trade balance into a deficit of 1948. In the first six months of 1948, bizonal receipts from the French Zone were RM 54.6 million, while deliveries from the Bizone were RM 196.3 million.

During 1948 steps were taken to integrate the foreign trade of the French Zone with that of the Bizone through the JEIA, culminating in a fusion with the Bizone on 18 October. As a result it became necessary to provide direct outside assistance. For the fiscal year 1948-49, ECA grants to the French Zone amounted to about \$100 million, to cover expected dollar deficits. ECA estimates dollar aid requirements for 1949-50 at \$115 million.

Even under the most optimistic assumptions as to production and distribution of indigenous food supplies, imports of breadgrains will continue to be needed to supply about one-half of the bread ration and one-fourth of the total caloric intake of the population. Manufacturing industries, however, are expected by the last year of the ERP to have recovered sufficiently to provide a net export surplus to Western Europe.

(3) *Soviet Zone.*

The USSR consistently blocked agreement on quadripartite allocation of foreign exports

from Germany and veiled the export transactions of the Soviet Zone in secrecy. Lists of commodities to be exchanged are published, but little information is given about the actual volume or value of the trade. The USSR is always the principal beneficiary of such foreign-exchange proceeds as are realized from Soviet Zone exports. This does not include reparations which constitute the largest part of goods removed from the country. In 1948 and 1949 the Soviet Zone concluded trade agreements with a number of foreign countries, including Belgium, the Netherlands, Sweden, and Poland. The export-import deals negotiated within the framework of these agreements are largely handled by the Soviet-established German Central Administration for Foreign Trade, the purpose of which, as stated by the USSR, is to stimulate the expansion of export trade, particularly toward the Soviet Union, Poland, and the Danubian states. Outside of these trade agreements a relatively large share of German export trade is conducted through a number of Soviet-controlled export companies, with the compensation goods or foreign exchange proceeds benefiting the Soviet rather than the German economy. The principal items of export are potash, which the Soviet Zone possesses in abundance, timber, scrap iron, machinery, and chemicals. Chief imports since the lifting of the counterblockade in May 1949 are raw materials including cotton, wool, machinery and parts, semi-finished steel products and chemicals for state-owned enterprises producing for the Soviet account.

Although the USSR planned an ambitious foreign trade development program for the Soviet Zone in 1948, fulfillment was seriously curtailed by the imposition of the Western Powers' counterblockade and by the ensuing production difficulties arising from shortages of vital materials previously obtained from the western zones. It was the intention of the USSR to channel the great bulk of Soviet Zone trade eastward, but the satellite countries proved unable or unwilling to exchange commodities with the Soviet Zone in the quantities or types required by the zonal economy. Consequently, an unfavorable balance-of-trade developed, with imports exceeding ex-

SECRET

II-33

ports (excluding reparations payments) by a considerable amount, and the USSR contributing heavily for the first time from its own stocks to maintain the faltering economy of the zone. Zonal imports for 1948 were RM 356.2 million, of which the USSR contributed RM 88.2 million; and exports were only RM 274.2 million, of which RM 40.5 million went to the USSR. Although this trade was considerably in excess of the total 1947 foreign trade, its distribution is significant in view of the East-West controversy. Less than one-fourth of the imports were from Western Europe, and exports to that area were correspondingly small. Imports in the first quarter of 1949 appeared to have increased about 50 percent over the 1948 rate, while exports increased over 95 percent.

In 1948 the Soviet Zone sent about RM 104 million worth of goods to the Bizone and received from that area about 140 million RM worth. Much of this was raw material and about 85 percent of it was shipped before August when the counterblockade went into effect.

3. Economic Stability

a. Western Zones.

During the first two years of Occupation, conflicting Allied policies served only to deepen the confusion and uncertainty which their material assistance was intended to correct. In view of the low levels of production attained, the worthlessness of the currency as a measure of relative values, and the low level of foreign trade, only strict rationing of necessities and stringent price, wage and rationing controls prevented the economies of the several zones from deteriorating.

The Soviet action in breaking up the Allied Control Council on 20 March 1948 may have put a permanent end to quadripartite efforts to forge an economic entity of Germany; nevertheless, it released the western zones from the baneful effects of Soviet tactics obstructive to economic recovery. The western Allies countered the Soviet action by moves aimed at increasing production in the western zones, beginning with the currency conversion in June. This step alone resulted in the re-

lease of hoarded goods and in a steady increase in production in the western zones. A level approximately 88 percent of 1936, attained in May 1949, was maintained during the summer months.

Important among the factors which obscure the outlook for further recovery in the western zones is the question of future control of the area containing most of the steel industries and hard coal deposits—the Ruhr. The US and UK decided on 10 November 1948 to give temporary management of Ruhr industries back to the Germans. This decision allows German trustees to operate the industries until the new German Government in the western zones acts to socialize them or to return them to private ownership. The decision was made in the belief that increased production would result, that this in turn would relieve US and UK taxpayers of occupation cost burdens, and that it would ensure a maximum contribution from western Germany to recovery in Western Europe. French concern regarding a too rapid revival of German industry was partially allayed by a six-power agreement reached 28 December 1948, establishing an International Authority for the Ruhr with power to control minimum export allocations of coal, coke, and steel from the area. The agreement was signed and went into effect on 28 April 1949 amid German fears that the area was permanently lost to the German economy.

Numerous other factors cloud the economic future of the western zones. To the extent that the area continues to be cut off from the foodstuffs, raw materials, and manufactures of eastern Germany, it must remain the more dependent upon foreign trade. The prospects for the attainment of prewar levels in trade with eastern Europe are not bright. Trade with the West, although contingent upon the continued success of the ERP, will probably improve.

Further increases in production in the western zones is being hampered by an inadequate investment program and by the unsettling effects of the necessity for reorganization of the tax system and division of responsibilities between the lower levels of government and the new central government. New capital

goods are badly needed, but foreign investors are reluctant and the internal economy is not able to provide funds necessary for the purchase. Labor unrest, strikes, and a reduction in the productivity of labor are encouraged by the need for further tax reform, broad-scale domestic readjustments in prices and wages, and a reduction in occupation costs.

Factors favorable to improvement in the economic situation are the continuing ERP aid to western Germany and to Western Europe and the fear of Soviet expansion, a fear which strengthens morale in the western zones and is conducive to German support of Allied efforts to improve economic conditions. Germany also possesses a reservoir of highly skilled labor, great technical skill and ingenuity, and a will to dominance in all fields which should assist in overcoming the obstacles now hampering economic recovery.

b. Soviet Zone.

Despite the Soviet currency reform in June 1948, production in the Soviet Zone declined in subsequent months. The decline there was in part attributable to Soviet removals without compensation of both current output and plant equipment. In part also the Soviet blockade of Berlin was responsible, since in re-

taliation for the blockade the western Allies promptly embargoed the shipment of goods from the western zones to the Soviet Zone.

With the lifting of the counterblockade in May 1949, there was a revival of industrial output, although it is doubtful if quotas under the Two-Year Plan can be met in view of continuing shortages. The full restoration of interzonal trade relations may see further improvement in eastern German economic conditions. There is slight indication, however, that further improvement in general production levels will improve the general public's consumption standards. Gains will be registered only in those industries and for those groups favored by SMA. The area as presently bounded is not self-sufficient in foodstuffs. The area, moreover, normally imported coal and manufactures from western Germany and elsewhere. The satellite countries are not able to provide substitute supplies, because their surpluses (except for Polish coal) are channeled to the USSR or are traded within the Soviet orbit. There is evidence that this economic outlook gives less concern to the SMA than the development of governmental organization and controls similar to those of the Soviet Union.