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Constraints and room for manoeuvre in the German inflation of the early 1920s

By NIALL FERGUSON

The relentless increase of our floating debt depresses the purchasing power of our money, restricts our credit and pushes prices to fraudulent heights. The volume of paper money is no sign of prosperity, (Quite right!) but a measure of increasing impoverishment. (Renewed agreement.) And the more the value of money collapses, the more violent become the struggles over wages and salaries, which despite everything are rarely able to keep pace with the rise in prices. An endless ratchet! It poses the gravest possible threat to trade and transport, to every branch of industry and labour. This danger must be countered with every available means, if we are to protect our people from the fearful misery of a collapse not only of the state finances but also of the nation’s economy. God forbid that our people should only come to understand the full extent of our present plight as a consequence of [such] a collapse! For this reason we must promote the reform of the Reich’s finances with the utmost urgency. (Interjection from the Independent Social Democrats.) That will require a great sense of public responsibility on the part of the whole population.

(Chancellor Fehrenbach in the Reichstag, 28 June 1920)

Historians of the Weimar economy can be divided roughly into two groups: those who maintain that politicians and other decision-makers had ‘room for manoeuvre’, and those for whom essentially uncontrollable economic or ‘structural’ factors were decisive. In many ways, the long-running debate about possible ‘alternatives’ to the deflationary policies of Chancellor Heinrich Brüning between 1930 and 1932 reflects this basic dichotomy between—to put it crudely—believers in political ‘free will’ and economic determinists. Yet there is an imbalance in the historiography. Although considerable effort has gone into debating the options open to politicians in the slump, remarkably little has been said about alternatives to the policies pursued 10 years earlier, during the period of inflation. It has often been argued that Brüning’s policies intensified the deflationary pressures inherent in the German economy after 1928. But it can also be

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¹ This is a version of a paper presented at the conference on ‘Stabilising Europe, 1918-1945-1980’, University of Keele, 1995. I wish to thank the organisers, in particular Dr Mark Roseman, and the other participants for their comments. I would also like to thank anonymous referees for their detailed criticisms. Above all, I am profoundly indebted to Prof. Knut Borchardt for generously reading and commenting on two drafts. Needless to say, I take sole responsibility for all the views expressed and any errors which remain.

² Quoted in Paddags, ‘Weimar inflation’, p. 45.

³ See especially Holtfrerich, ‘Alternativen zu Brünings Wirtschaftspolitik’; idem, ‘Was the policy of deflation unavoidable?’; idem, ‘Economic policy options’. In general, von Krüedener, ‘Could Brünings policy of deflation have been successful?’

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said that the politicians in charge of German economic policy after 1918 intensified the inflationary pressures which the Weimar Republic inherited from the First World War. The slump may have dealt a more obviously lethal blow to the Republic; but, as economic historians have come to appreciate, the damage done by the inflation was severe too—perhaps equally so. Yet, compared with Brüning and his colleagues, the politicians who presided over the inflation have been let off relatively lightly. There remains an extremely resilient consensus that there was no alternative to the policies they pursued; that they were the more or less helpless victims of inexorable structural pressures—that the inflation, in other words, was inevitable.

There are two possible reasons for this determinist consensus. Partly, it may simply be because the Weimar Republic survived the inflation, but did not survive the slump; consequently, there has seemed less reason to question the policies pursued in the earlier crisis. To be sure, 1919-23 was, in some ways, a crisis every bit as big as the deflationary crisis 10 years later—arguably bigger, in the sense that the Reich’s very integrity seemed in jeopardy. But in 1923/4 it proved possible, with the use of presidential power, ‘enabling’ legislation, and emergency decrees, to achieve an economic ‘regime change’ without destroying Weimar’s essential institutions of parliamentarism, federalism, and corporatism. In 1933/4, by contrast, the economic regime was only changed in the context of a complete political restructuring which replaced these institutions with the ‘leader principle’, the unitary state, and a command economy. There is, however, another (perhaps more ideological) reason for the neglect of alternatives to the inflation. The retrospective critique of Brüning has been, broadly speaking, Keynesian: critics of Borchardt’s seminal ‘defence’ of Brüning have essentially argued that a counter-cyclical policy of job-creation financed by government borrowing, such as a few proto-Keynesians advocated after 1930, would have worked. It has been to some extent gratifying for a later generation of economic historians to shake their heads at the naïvety of Brüning and his advisers, with their supposedly obsolescent fears of such a policy. To question the policies pursued after 1919, by contrast, is to challenge the legitimacy of a policy which explicitly put job creation before price stability. Perhaps economic historians of the present generation have hesitated to take such a position, lest they be thought to harbour monetarist leanings, with all that those might imply.

The argument that inflation was inevitable owes much of its resilience to the idea that, in the words of Graham, ‘the balance of material gains and losses’ for the economy as a whole was ‘on the side of gains’. This view was developed in the 1960s by two Scandinavian Keynesians, Laursen and

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4 Borchardt, ‘Zwangslagen und Handlungsspielräume in der großen Weltwirtschaftskrise’; idem, ‘Wirtschaftliche Ursachen’.
5 Büttner, ‘Politische Alternativen zum Brüningschen Deflationskurs’.
Pedersen, and subsequently refined by Abelshauser and Petzina. Not only did output increase in 1920, 1921, and 1922, it was argued, but so did investment, creating a potential for sustained growth which only the depressed conditions of the post-1924 period prevented from being put to use. A vital piece of evidence in this case is the fact that German employment levels were unusually high by international standards in the years 1920-2. This was what Graham principally had in mind when he wrote that ‘Germany accomplished the actual process of transition from the war to a stable post-war monetary structure at a lower real cost’ than Britain and the US. Most modern economic history textbooks have been at pains to stress these relative advantages of inflation, at least for the period preceding hyperinflation. By implication, an alternative policy would have led to lower growth, lower investment, and higher unemployment.

In fact, there are good reasons to question such ‘optimistic’ assessments. The inflation had far higher costs than Graham or Laursen and Pedersen appreciated. The Italian economist Bresciani-Turroni, who wrote one of the first academic studies of the subject in 1931, listed them as follows: falling productivity; a misallocation of resources; ‘profound disequilibrium in the economic organism’; ‘the vastest expropriation of some classes of society that has ever been effected in time of peace’; and declines in public health and morality. He went on:

It annihilated thrift . . . . It destroyed . . . moral and intellectual values . . . . It poisoned the German people by spreading among all classes the spirit of speculation and by diverting them from proper and regular work, and it was the cause of incessant political and moral disturbance. [. . . Moreover,] by reinforcing the economic position of those classes who formed the backbone of the ‘Right’ parties, i.e. the great industrialists and financiers, [it] encouraged the political reaction against democracy.

There is not much there with which Feldman, the author of the most recent and definitive study of the inflation, would disagree. He and his associates in the project which culminated in the publication of The great disorder have produced a vast quantity of evidence which supports most, if not all, of these points. In particular, the claim that the inflation stimulated investment

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7 Laursen and Pedersen, German inflation.
9 Graham, Exchange, prices and production, pp. 278f., 317f.; Laursen and Pedersen, German inflation, pp. 77, 123; Petzina, Deutsche Wirtschaft, p. 16; idem, ‘Arbeitslosigkeit in der Weimarer Republik’.
11 Stolper et al., German economy, pp. 72-93; Borchardt, ‘Wachstum und Wechsellagen’; Henning, Das industrialisierte Deutschland, pp. 63-83; Blaich, Der schwarze Freitag, pp. 9-58; Braun, German economy, pp. 33-41.
12 Bresciani-Turroni, Economics of inflation.
14 Büssch and Feldman, eds., Historische Prozesse; Feldman et al., eds., Zwischenbilanz; Feldman et al., eds., Erfahrungen; Feldman et al., eds., Anpassung; Feldman et al., eds., Konsequenzen; Feldman and Müller-Luckner, eds., Nachwirkungen.
has been called into question by the work of Lindenlaub, whose detailed study of engineering firms suggests that rising prices (or to be precise, uncertainty about future prices) actually discouraged investment. The year of stable prices, 1920, was when firms undertook new capital projects, and many of these had to be abandoned when inflation resumed in 1921. More generally, it seems hard to deny that whatever benefits the inflation conferred in 1921 and 1922 were compensated for by the sharp falls in production and employment after hyperinflation set in. Finally, Balderston has argued persuasively that, because of its damaging effects on the banking system and the capital market, the inflation was indirectly responsible for the onset and peculiar severity of the slump in Germany. Yet—although criticism has been levelled often enough at the failure to reduce government deficits, and at the sustained laxity of monetary policy—there have been few attempts to suggest that this calamity could have been avoided.

A distinction needs to be made explicit at this point which is often implicit in the literature, between the economically possible and the politically possible. Despite acknowledging the negative consequences of the inflation, many writers nevertheless conclude that there was no political alternative available. This is partly a consequence of more sophisticated research on (and a better theoretical understanding of) the distributional consequences of inflation. Where earlier accounts portrayed big business as the sole beneficiaries of the inflation, reaping the benefits of low real interest rates, low taxation, and a weak exchange rate, it is now clear that real wages and consumption were eroded less by inflation than had previously been thought. Big and small rural landowners also benefited from having their mortgage debts wiped out; and Hughes has suggested that the net losses suffered by savers and investors were less severe than was once believed. This idea of the inflation as a great, and in some ways just, leveller has been strongly emphasized by Holtfreicher. The implication is clear: a different policy would have been less fair: rentiers would have been favoured by a state which honoured its debts, while debtors, entrepreneurs, and workers would have lost out.

This, of course, was how Keynes portrayed the political options in his *Tract on monetary reform*. Inflation, as Keynes put it, was the only tax which

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16 Balderston, ‘Links between inflation and depression’; *idem*, *Economic crisis*.
20 See e.g. Scholz, ‘Lohn und Beschäftigung’; Osmond, ‘Peasant farming’; Moeller, ‘Winners as losers’.
21 Hughes, *Paying for the German inflation*; *idem*, ‘Economic interest’.

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was politically acceptable. More recent writers have put it rather more subtly, arguing that the inflation was the unplanned outcome of a tacit 'inflationary consensus' between industry, organized labour, and other social groups averse to deflation. Despite the negative consequences of the slide into hyperinflation, so the argument goes, it would have been extremely hard for any democratic government to have gone against this consensus by reducing the budget deficit or tightening monetary policy. In an influential article, Haller estimated that tax levels would have needed to exceed 35 per cent of national income to balance the budget without further government borrowing; a level of taxation we would now consider modest but which, according to Haller, would have been politically intolerable in the early 1920s. A similar argument has been advanced that stabilization would have made the cost of servicing the public debt politically unbearable.

Inflation is thus said to have 'secured the parliamentary form of government for the period of the Weimar Republic', since any attempt to have stabilized fiscal and monetary policy would have led to a political crisis.

In fact, all these justifications for the inflation have their origins in the contemporary policy debate. At a meeting with the American ambassador in Berlin in June 1922, the German Foreign Minister Walther Rathenau and the industrialist Hugo Stinnes offered two differing, but complementary justifications for German policy:

[Rathenau] held ... that inflation was no worse economically than controlling rents and maintained it only took from those who had and gave to those who had not, which in a country as poor as Germany was entirely proper. Stinnes ... declared the choice had been between inflation and revolution and as between the two he favoured inflation.

For Stinnes, inflation was 'the only way of giving the population a regular employment, which was necessary to secure the life of the nation'. ‘It was,’ he later told Houghton, ‘politically necessary to put at work three million men coming back from the war. It was ... a question of your money or your life.’ The Hamburg banker Carl Melchior made a similar point:

It was politically and socially necessary at the time and ..., could it have been controlled, no permanent harm would have occurred. It was not planned. It came about from the tremendous budget deficiency at the close of the war, when

26 Schacht, Stabilisation of the mark, p. 50ff.; Webb, 'Government revenue and spending', p. 56.
27 Haller, 'Rolle der Staatsfinanzen', p. 151.
29 James, German slump, p. 42.
30 National Archives, Washington, RG 59, 862.00/1199, Houghton to Secretary of State, 27 Dec. 1922.

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they had no funds. It became involved in the creation of new capital to enable
industry to hire the returning soldiers.31

Elsewhere he argued that the huge deficit on the publicly owned railways
was necessary ‘to avoid putting . . . 100,000 disposable employees . . . onto
unemployment benefit and thus handing them over to political radicalism’.32
Writing in November 1923, his senior partner Max Warburg underlined
the point: ‘It was always a question of whether one wished to stop the
inflation and trigger the revolution.’33 Nor were such views peculiar to
businessmen. The trade unionist Paul Umbreit was essentially making the
same point when he argued against cuts in social expenditures: ‘If economic
and social effects are set in opposition to one another, then the social
interests have to be given precedence.’34

For contemporaries, however, there was an even more important argument
against stabilization, one which Stinnes and company tactfully failed to
mention in their conversations with the American ambassador: the need to
avoid paying reparations. The idea that reparations were to blame for the
inflation, of course, was one they happily repeated at every opportunity. As
Melchior put it, the inflation only ‘grew out of control owing to the demands
on German resources from abroad’.35 In part, this was simply an extension
of the view summarized above that fiscal balance was impossible. The
German budget was already badly out of kilter; but the Allies’ demand for
cash reparations made matters much worse.36 A further argument, popularized
though not originated by Keynes, was that a structural deficit on the German
balance of payments, due to confiscation of various productive assets under
the terms of the Versailles Treaty, made it impossible for Germany to obtain
the foreign currency required to transfer reparations to the Allies.37 And
even if the Germans could have been taxed until the proverbial pips squeaked,
the necessary export surplus was not in the interests of the collectors of reparations themselves.38 Germany therefore had no option but
to buy hard currency by selling paper marks, thus driving down the
exchange rate, pushing up import prices and hence the domestic price
level.39

Once again, the historiography tends to elide the economically difficult
and the politically impossible. A conclusion frequently drawn is that German
governments, expected by the Allies to raise taxes to pay for reparations
which were almost universally unpopular, had no alternative but to seek to

32 Warburg Archive, M.M. Warburg & Co., Hamburg, Politische Correspondenz 1921, Melchior to S.
Japhet, 15 Jan. 1921.
34 Feldman, Great disorder, pp. 249, 253.
35 National Archives, Washington, RG 59, 862.00/1199, Houghton to Secretary of State, 27 Dec.
1922.
Reparationsproblem der Weimarer Republik’; Holtfrerich, German inflation, pp. 137-55; Webb, Hyper-
inflation, pp. 54, 104, 107. See also Eichengreen, Golden fetters, pp. 125-51.
37 Keynes, Economic consequences, pp. 103-210.
38 Idem, Collected writings, xvii, pp. 207-13, 234, 249-56.
39 See e.g., Bonn, Stabilisierung der Mark. Cf. Bresciani-Turroni, Economics of inflation, p. 45; Graham,

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avoid paying. The most obvious way to do this was to allow inflation to continue, for, to quote Graham again, the contemporary view was ‘by no means without justification that improvement in the public finances would lead to still more severe exactions’.\(^{40}\) It also made political sense, according to Graham, to allow currency depreciation to continue unchecked, since that had the effect of boosting German exports.\(^{41}\) This should have put pressure on the Allied economies, forcing them to accept that reparations could only be paid at the expense of Allied industry. Depreciation was therefore, according to Holfrericher, ‘in the national interest’, the most effective way of ‘persuading the rest of the world of the need for a reduction of the reparations burden’.\(^{42}\) Indeed, the strategy had a double advantage: because so much of the money lent to Germany in the period was never repaid, one historian has gone so far as to speak of ‘American “reparations” to Germany’.\(^{43}\)

Such thoughts clearly did cross the minds of contemporaries. Chancellor Wirth himself, supposedly the advocate of ‘fulfilment’, opposed the introduction of a property levy (or ‘seizure of real values’, in the contemporary catch-phrase) on the grounds that it would only encourage the Allies: ‘The goal of our entire policy must be the dismantling of the London Ultimatum. It would therefore be a mistake if, by initiating a seizure of real values at this moment, we were [in effect] to declare the Ultimatum to be 80% possible.’\(^{44}\) The State Secretary at the Foreign Office, Fischer, captured the prevailing mood in early 1922 when he described the Reparations Commission’s ‘wish for a further increase in taxes’ as implying a ‘wish for the economic destruction of Germany’.\(^{45}\) Nor did the international distributional effects go unnoticed. Keynes, who was in close communication with influential figures such as Warburg and Melchior, was one of the first commentators to point out that inflation was defrauding foreign holders of marks.\(^{46}\)

For all of these reasons, then, the inflation, for all its negative economic consequences, is now generally seen as having been politically inevitable: the partly conscious, partly unintended product of internal and international distributional conflicts. Although Feldman briefly toys with the idea that stabilization might have been achievable in late 1922, the inevitability of hyperinflation is essentially the ‘bottom line’ of The great disorder. Quite apart from the multiple domestic conflicts of economic interest, he suggests, the Allied peace terms ‘made impossible demands and promoted intolerable choices’; reparations were ‘a disincentive to stabilise’. ‘Inflation’, he concludes, ‘was the least undesirable means of dealing with Germany’s problems in the


\(^{43}\) Schuker, ‘American “reparations” to Germany’.

\(^{44}\) von Specht, *Politische Hintergründe*, p. 75.

\(^{45}\) Foreign Office Library, Cornwall House, German Foreign Ministry duplicate series, 3243/D713267, Kabinetsprotokolle, Chefbesprechung, 23 March 1922.

\(^{46}\) Ferguson, *Paper and iron*, p. 245.
post-war years'. While accepting that this may have been what many contemporaries thought (or hoped), this article questions whether this was actually the case. Although there clearly was a consensus that the net costs of the inflation were less than would have been the net costs of any other policy, it is by no means proven that this political consensus was economically correct. Fehrenbach’s appeal for stabilization in 1920 may have fallen on deaf ears (despite the generally approving responses his speech elicited). But his fundamental point, that it would be better to stabilize in 1920 than to learn the hard way by descending into hyperinflation, was all too prescient.

To be fair, a few historians have already raised the possibility of alternatives to the inflation, though virtually nowhere in the literature is a policy of fiscal or monetary tightening seriously considered. In an earlier article, published in 1982, Feldman made the case for a rather different alternative policy, arguing that it was not the policy of easy money which was wrong, so much as the refusal of the Reichsbank, and the banking world generally, to acknowledge that the credit system had become dependent on ‘hot’ foreign money, speculatively invested in the expectation that the mark would recover. Had the bankers accepted, instead of intransigently opposing, Hirsch’s scheme for a Reich Economic Bank, the credit system might have been better insulated against the sudden fall of foreign confidence in the mark following the London Ultimatum in May 1921. Another ‘alternative scenario’ has been suggested by Witt, who argues that early Weimar governments attempted ‘something like counter-cyclical policy’. They aimed at an ‘integrated, economic, social and financial policy with the explicit goal of securing . . . democracy’ by means of subsidies to industry to maintain employment; progressive taxation; trade and exchange controls; and workers’ participation in management through works’ councils. Finally, Maier has suggested that tighter exchange controls might have helped the Wirth government to withstand the inflationary pressures of mid-1921.

Like both the ‘early’ Feldman and Witt, this article sees 1920 as the key opportunity for stabilization. And like them, it too suggests that the ‘relative stabilization’ of 1920 could have been prolonged and the hyperinflation avoided if different policies had been adopted. However, the alternative policies proposed here are different from theirs. In particular, it is suggested that smaller public sector deficits achieved by cuts in spending and higher indirect taxation, together with a monetary stabilization based on a formal devaluation of the paper mark’s gold (i.e., dollar) exchange rate, could have effectively ended inflation (particularly if combined with a partial deregulation, rather than increased regulation, of trade and the labour market). Such policies would not have had the severely negative economic, social, and political effects feared by contemporaries and imagined by subsequent historians. The ‘counterfactual’ scenario envisaged here would not have meant drastic deflation, on the British model, but merely a consolidation of the postwar position. Although this would probably have

47 Feldman, Great disorder, esp. pp. 255·72.
48 Idem, ‘Relative stabilisation’.
49 Witt, ‘Staatliche Wirtschaftspolitik’.
50 Maier, Recasting bourgeois Europe, p. 69.
meant falls in output and employment, these would have been significantly less than those which actually happened in 1923. Moreover, stabilization would not have undermined Germany's revisionist foreign policy. In fact, continued inflation did not, as contemporaries believed, put pressure on the Allied economies to revise the reparations terms of the peace. On the contrary, by stimulating German imports from the Allied economies, inflationary policies weakened Germany's bargaining position, diminishing the pressure on Britain and America to side with Germany against France. A tighter fiscal and monetary stance would in fact have been a more effective weapon against reparations. Finally, by avoiding hyperinflation, Germany would have done less long-term damage to its money and capital markets. Although foreign investors would have been disappointed by devaluation, they would have been less disappointed than they subsequently were by the complete collapse of the mark. Even more quickly than they did after 1923, they would have been inclined to return to investing in and lending to Germany (and perhaps on better terms).

Self-evidently, this is an argument based on hindsight. Contemporaries could not know in 1920 what lay in store for them in 1923, and Fehrenbach clearly failed to persuade the Reichstag parties that balanced budgets today were preferable to hyperinflation tomorrow. Yet arguments based on hindsight are not inadmissible if it can be demonstrated that the contemporary calculations which led to continued inflation were flawed.

II

The starting point for any counterfactual analysis must be the opportunity for stabilization which presented itself in 1920. Of course, the first half of 1920 was characterized by considerable political instability especially between March (the Kapp putsch) and June (the Reichstag elections). But economically this was a time of international deflation as the British and American monetary and fiscal authorities began to take steps to settle the bills run up during the war and to end inflation by raising taxes and restricting credit. 1920/1 saw severe deflation in both countries, and this deflation tended to spread to their trading partners. In Germany too, prices stopped rising—indeed, fell. This had two causes: lower import prices as a result of UK and US deflation, and the unexpected recovery of the mark exchange rate brought about by a large influx of foreign capital in the second half of 1919. In March 1920, as figure 1 shows, the mark suddenly ceased its steep postwar descent, rising against the dollar from 99.11 to a peak of 30.13 in June. At the same time, domestic prices fell by around 20 per cent from a peak in March 1920 to a trough in July, and then fluctuated at

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51 Aldcroft, Inter-war economy, pp. 34-7; Friedman and Schwartz, Monetary history, pp. 229-32. Cf. Dowie, '1910-20 is in need of attention'.


53 As far as can be established, there was a net capital inflow to Germany of around 4 billion gold marks in 1919: Ferguson, Paper and iron, pp. 241-6. Cf. Holtfrerich, 'Internationale Verteilungsfolgen der deutschen Inflation'; idem, 'Die deutsche Inflation 1918 bis 1923 in internationaler Perspektive'; Schuker, 'American “reparations” to Germany'.

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roughly 13 times their prewar level until the summer of 1921. In May 1921, the annual inflation rate sank to a postwar low of 2 per cent. The question is therefore whether anything could have been done to make this ‘relative stabilization’ last.

Figure 1. Inflation indicators, 1918-1920 (1913 = 1)
Sources: Bey, Wages, pp. 422-9, 440-5; Holtfrerich, German inflation, p. 17; Laursen and Pedersen, Inflation, pp. 133-5

Clearly, any attempt to restore the mark to prewar parity on the British pattern was out of the question; a drop in output of nearly 5 per cent and an unemployment rate of over 10 per cent (the effect of British deflationary policies in 1920/1) would, it seems fair to say, have been politically unsustainable.\textsuperscript{54} But could not the mark have been stabilized at, say, 50-60 marks per dollar or 8-10 per cent of its prewar value?\textsuperscript{55} Such a stabilization (not unlike that which occurred in France and Belgium) would not have entailed a British-style slump. Nor should it simply be assumed that Germany, as one of the war’s losers, was doomed to experience hyperinflation, along with Austria, Hungary, Poland, and Russia. The victors had to contend with comparably serious inflationary pressures after 1918; while the other countries which experienced hyperinflation had more serious political problems than Germany: Austria and Hungary had been rent asunder, a newly independent Poland was at war with Russia, and Russia itself was in the grip of revolution and civil war.\textsuperscript{56}

The first step towards an enduring German stabilization in 1920 would


\textsuperscript{56} Sargent, ‘Ends of four big inflations’; Capie, ‘Conditions’, pp. 125ff.
have been a partial (though not, it should be stressed, a total) reduction in the budget deficit. As figure 2 shows, this was only slightly reduced in 1920 and 1921 as compared with 1919. As a proportion of estimated Net National Product, the deficit fell from around 18 per cent in 1919 to 16 per cent in 1920 and 12 per cent in 1921. It goes without saying that these deficits were excessive, especially given the fact that they were being financed largely by short-term borrowing. Why were they not more steeply reduced? It was certainly not for want of tax increases, for in putting into practice his maxim that ‘a good Finance Minister is the best Socialization Minister’, Erzberger had attempted a drastic increase in direct taxation before his departure from office in March 1920. The National Assembly had already passed substantial levies on wartime increases in personal wealth and income; now the ‘Reich emergency levy’ (Reichsnnotopfer) taxed property above 10,000 marks at rates rising from 10 per cent to 65 per cent, while the Reich income tax envisaged a top rate of 60 per cent on income above 500,000 marks.


Yet this did not suffice to reduce the deficit. First, there was considerable evasion, much of it within the law. For example, the ‘emergency levy’ was payable in instalments over periods as long as 47 years, with interest charged at only 5 per cent after December 1920.57 So long as inflation remained above 5 per cent, delayed payment was clearly advantageous. Likewise, those whose incomes were not paid as wages (from which tax was deducted

57 Webb, Hyperinflation, p. 33f.; Flemming et al., 'Sozialverhalten und politische Reaktionen', p. 259.

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at source) could easily defer payment of the new Reich income tax. As a result, wage-earners in fact paid a rising share of this supposedly progressive tax.\textsuperscript{58}

Better-designed taxes could thus have raised more revenue: Webb has calculated that, if the revenues from the income tax had not been eroded by the ‘Tanzi effect’ of renewed inflation after mid-1921, the real primary deficit (net of debt service) for the period July 1920 to June 1921 would have been just 1.31 billion gold marks (around 4 per cent of NNP), as opposed to over 5 billion gold marks.\textsuperscript{59} More practically, if Erzberger had also increased taxes on consumption, the whole tax package might have seemed less like ‘fiscal socialization’ to the middle classes. Under Erzberger’s reforms, the share of Reich tax revenue coming from direct taxation rose to around 60 per cent in 1920/1 and 75 per cent in 1921/2, compared with just 14.5 per cent (including stamp taxes) before the war.\textsuperscript{60} This was too high. What is more, higher taxes on consumption, though seen on the left as politically retrograde, would have been easier to collect.

Yet these inadequacies on the revenue side were probably less important than the government’s continued spending policies in ensuring the persistence of deficits. The 1920/1 budget was expected (in December 1920) to show a deficit of 83 billion marks, with tax revenues covering just over one-third of total spending, a figure only slightly improved (to 44 per cent) the following year.\textsuperscript{61} As a proportion of NNP, total public spending in 1920 was unchanged on the previous year (around 42 per cent), and fell only slightly (to 37 per cent) in 1921.\textsuperscript{62} Contemporary figures (see figure 3) clearly show the erratic trend of spending in real terms, with large increases in June and December 1920 and again in February 1921, as do Webb’s deflated quarterly figures (figure 4).

Why did it prove so difficult to reduce government spending to a level compatible with tax revenue? It was partly, of course, because of reparations, which accounted for one-fifth of the Reich deficit in 1920, and more than two-thirds in 1921.\textsuperscript{63} But it is an oversimplification to say, as does Eichengreen, that they were therefore ‘ultimately responsible for the inflation’.\textsuperscript{64} The reparations burden needs to be put in perspective. When the total indemnity was finally set in 1921, 82 billion of the 132 billion gold marks were purely ‘notional’, in that so-called ‘C bonds’ to that value would


\textsuperscript{59} Webb, \textit{Hyperinflation}, pp. 52ff. See also Eichengreen, \textit{Golden fetters}, pp. 139-42.

\textsuperscript{60} Figures calculated from Witt, ‘Tax policies, tax assessment and inflation’, p. 156f. Prewar figures in Witt, \textit{Finanzpolitik}, p. 379. By the early 1920s, the most important form of indirect taxation was the Umsatzsteuer, a tax on business turnover introduced during the war.

\textsuperscript{61} Feldman, \textit{Great disorder}, pp. 322ff.


only be issued at some unspecified future date when German economic recovery was sufficiently advanced. This cast a shadow over the future, but it meant that Germany's immediate obligations in 1921 were less than 50 billion gold marks—as little, in fact, as 41 billion (taking account of what had been paid after 1919). That had been the sum regarded as payable by Keynes in *The economic consequences*. Moreover, and this is a point often overlooked, inflation had already substantially reduced the real value of the Reich's internal debt by mid-1921 to around 24 billion gold marks (see figure 4 for the falling real cost of debt service). So as a proportion of national income, the Reich's total liabilities including the A and B bonds amounted to around 160 per cent.65 This was approximately the same as the ratio of the British national debt to national income in the same year. As it turned out, total expenditure under the terms of the Versailles treaty in the years 1920 to 1923 amounted to at most 15 per cent of total public spending;66 and even if reparations payments are subtracted, that total was

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65 Calculated as follows: total nominal Reich debt in 1921 (352.2 billion marks) divided by gold mark index for May 1921 (14.83) plus reparations due (41 billion gold marks) divided by estimated national income in 1921 (40.4 billion gold marks).

still running at around 33 per cent of NNP, compared with around 18 per cent before the war. Reparations account for only about one-third of that increase. And although without reparations inflation might have been lower and revenues therefore higher, it is still conceivable that there would have been deficits. It cannot be assumed, as it is by Eichengreen, that domestic spending would not have risen had reparations magically been abolished.

![Graph showing real Reich revenue and expenditure, 1919-1923 (quarterly averages, million gold marks)](image)

**Figure 4.** *Real Reich revenue and expenditure, 1919-1923 (quarterly averages, million gold marks)*

*Source: Webb, Hyperinflation, pp. 33, 37*

In addition to the dwindling real costs of servicing the funded debt, German reparations to Germans, which is how these social costs may be regarded, included higher spending on public sector pay, doles for the unemployed, of which the Reich paid half, subsidies for housing construction, and subsidies to keep down the costs of food. There was also the cost of paying pensions to over 800,000 war wounded, 530,000 war widows, and 1.2 million war orphans. The most notorious 'hole' in the budget, however, was the deficit run by the rail and postal systems. Before the war, the railways had been run by the states and had been relatively profitable (as they became again after 1924). After the war, having been taken over by the Reich, they rapidly ran out of financial control: the deficit on the Reichsbahn accounted for around a quarter of the total Reich deficit between 1920 and 1923. In part, this was a consequence of purchases of new rolling stock (the tonnage of goods vans increased by more than 10 per cent

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between 1920 and 1923), and a failure to maintain the real value of fares and freight rates. But it was also partly due to the government’s concern to maintain employment levels, which led to chronic over-manning. Between 1919 and 1922, the total numbers employed by the Reichsbahn exceeded 1 million, compared with some 750,000 before the war. The situation was similar in the postal, telegraph, and telephone system. In addition, the cost of reconstructing the German merchant marine (aimed at maintaining employment in the shipbuilding industry) accounted for as much as 6 per cent of total Reich expenditures in 1919 and 1920. Such ‘domestic reparations’ effectively wiped out the increased revenue generated by Erzberger’s tax reforms, ensuring the persistence of deficits.

There was nothing inevitable about this continuation of inflationary finance. What was lacking was a more rapid collection of income and other direct taxes, higher consumption taxes, and some corresponding cuts in public expenditure. To repeat: it would not have been necessary to balance the budget in 1920 to have increased the chances of an enduring stabilization; merely to have reduced the Reich deficit below the excessive level of around 16 per cent of NNP. To have halved that figure would have required tax increases of around 1.5 billion gold marks and spending cuts of the same order.

III

Fiscal policy alone cannot explain the failure of stabilization to endure, of course. Although monetary policy was largely influenced by the monetization of government debt, it was far from being a wholly dependent variable. The problem can be stated simply: in terms both of narrow money (currency in circulation) and of high-powered money, the rate of monetary growth was actually higher in 1920 than it was in either 1919 or 1921. This expansion was only partly due to the continuation of government deficits, since a rising share of treasury bills was held outside the Reichsbank in the same period. It reflected above all the high liquidity of the money markets and the static discount rate policy of the Reichsbank, which kept market interest rates at around 3.5 per cent and the discount rate at 5 per cent until 1922. Although the Reichsbank actually threatened to stop discounting treasury bills in 1919, it made no attempt to tighten credit conditions for the private sector. Indeed, at the first sign of such a tightening, it stepped in to maintain business liquidity: in the mild squeeze caused by the

71 Figures in Deutschlands Wirtschaft, Währung und Finanzen, pp. 107-10.
72 See Ferguson, Paper and iron, pp. 280ff.
73 Calculated from Holtfrerich, Inflation, p. 50f.
76 von Specht, Politische Hintergründe, pp. 28, 51f.; Holtfrerich, Inflation, pp. 165; Feldman, Great disorder, p. 158f.
strengthening of the mark in the spring of 1920, there was a marked increase in the volume of commercial bills discounted as a fraction of total note circulation. The Reichsbank not only opposed Erzberger’s plan for an administered reduction in the money supply (whether by means of a loan, or by the withdrawal or ‘stamping’ of certain banknotes), but also industriously increased the supply of new notes.

Once again, the question is whether there was any alternative. As Holtfrerich has shown, before May 1921, there was a discrepancy between the Reichsbank’s public explanation for inflation, which blamed the balance of payments deficit and reparations, and the Direktorium’s confidential advice to the government, which clearly blamed the growth of the Reich’s floating debt. But the government was under no obligation to heed Reichsbank advice. The only option open to the bank was therefore to use its discount rate in the hope of increasing the appeal of government bonds to the public and attracting foreign capital to Germany, though it is usually argued that such a tactic would have worsened the fiscal position, without necessarily increasing investor confidence. Yet there was another possible monetary policy. The Reichsbank’s traditional reserve requirements remained formally in force until May 1921. Admittedly, these rules had been substantially diluted by the decision to treat Darlehnskassenscheine (supplementary wartime currency) as equivalent to gold in the reserve, and Reich Treasury bills as equivalent to commercial bills. But by late 1920 the total volume of Darlehnskassenscheine had fallen by 12.5 per cent compared with the previous year; the amount of Treasury bills in the Reichsbank’s portfolio had risen by just 16.3 billion marks; while its gold reserve was almost exactly at its 1913 level at 1,091.6 million gold marks—19 per cent of the real value of currency in circulation, compared with 18 per cent in 1913 (see figure 5). A de facto stabilization of the monetary policy could thus have been undertaken in 1920 without necessarily causing a significant real monetary contraction. To escape the legal quagmire of an internal currency reform (with all the protests from creditors which that would have elicited even in 1920), the easiest route would have been to peg the paper mark’s exchange rate against the dollar at around 5 or 10 gold pfennigs. Historians have tended to stress the low quality of German monetary theory in this period; and certainly there were many economists who explicitly opposed policies of stabilization on thoroughly spurious grounds. But there were exceptions. A stabilization based on such an external devaluation had in fact been suggested by the economist Richard Häuser in July 1919.

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77 Graham, Exchange, prices and production, p. 64.
78 von Specht, Politische Hintergründe, p. 51f.
80 Holtfrerich, Inflation, p. 50; Besciani-Turroni, Economics of inflation, p. 448; Kroboth, Finanzpolitik, p. 494.
81 Hardach, ‘Zur zeitgenössischen Debatte’; Krohn, Geldtheorien in Deutschland’; idem, Wirtschaftstheorien als politische Interessen.
82 Häuser, ‘Zur Währungsfrage’.
What were the arguments at the time against such a stabilization? There were some advanced specifically against devaluation.\(^3\) For example, it was argued, firms and individuals with wartime foreign currency debts would be deprived of the theoretical possibility of some longer-term recovery of the mark.\(^4\) More important, however, was the fear of a domestic liquidity crisis or ‘credit shortage’. Even without a policy of stabilization, there were around two and a half times as many bankruptcies in the first half of 1921 as in the first half of 1920.\(^5\) It was for this reason that, far from debating monetary stabilization in 1920/1, German bankers and politicians debated the idea of an ‘economic bank’, whose main function would have been (pace


Feldman) to *expand* the supply of credit to industry and keep the inflation going.\(^{86}\)

IV

It was not, of course, bankruptcies *per se* which were feared, but the increased unemployment which would result. Many contemporaries regarded inflationary policies as 'the only way of giving the population a regular employment': in the words of Stinnes, the choice was 'between inflation and revolution'. This analysis has been accepted by most historians. Yet the assumption that policies of retrenchment would have triggered a 'second revolution' merits reassessment. There is a sense in which, just as later Weimar governments still feared inflation when it had ceased to be a threat, so early Weimar governments continued to fear revolution when it too had ceased to be a threat. The result in both cases, it can be argued, was the adoption of inappropriate policies.

There is no doubt that stabilization of the sort envisaged here would have increased unemployment in the short term. No attempt has been made here to estimate exactly the kind of contraction which would have been caused. Such a calculation would have to take account of the impact of job losses in the public sector (a necessary consequence of spending cuts) and

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*Figure 6. Unemployment, 1913-1934*
*Source: Petzina et al., eds., Sozialgeschichtliches Arbeitsbuch, III*
simultaneous reductions in private sector employment, the level of which would have depended heavily on business reactions to the adoption of stabilization policies. In ending foreign speculation in the mark and deterring future investment in German mark-denominated assets, devaluation would also have ruled out that expansion in the German trade deficit which occurred in 1921 and 1922, thus placing a ceiling on domestic consumption. On the other hand, there is good reason to think that price stability and a devalued currency would have encouraged businesses such as those studied by Lindenlaub to continue with the programmes of investment which they were beginning in 1920, but subsequently cancelled. Nor is there any reason to think that foreign lending would have ceased permanently. After all, it resumed very quickly in 1924, despite far heavier losses than a 1920 devaluation would have entailed. It seems reasonable to assume that, taking all these factors into account, any stabilization crisis in 1920/1 would have been less severe than the contraction experienced in 1923/4, when, in circumstances of complete monetary collapse, NNP fell by around 10 per cent and unemployment rose to a peak of 25 per cent of trade union members, not including more than 40 per cent who were on short-time work. Such levels of unemployment were not seen again in Germany until 1931. By contrast, unemployment in 1920 exceeded 5 per cent in only two months (July and August); for the year as a whole it averaged just 4.1 per cent (see figure 6). The experience of France, where a strategy of the sort suggested here was actually adopted, suggests that, at most, unemployment would have doubled in the event of stabilization. A rate of unemployment of 10 per cent of trade union members would have represented a significantly 'softer landing' than that of 1923/4.

Were Weimar politicians' fears of unemployment exaggerated in 1920? There is certainly evidence of numerous small-scale demonstrations by the unemployed at the time of the mark's relative stabilization in 1920. Coming in the wake of the anti-Kapp general strike, which had clearly radicalized workers in employment, and coinciding with sporadic consumers' protests against high prices, it is not surprising that these caused anxiety. To take just one example: in Hamburg there was a spate of ill-tempered demonstrations involving unemployed men, the worst of which led to an outbreak of looting so widespread that the authorities were forced to declare a state of emergency. Yet there was a certain lack of logic in lumping together these various manifestations of popular discontent as a single potentially revolutionary threat. For a policy of stabilization would have tended to reduce the radicalism of organized labour and the dissatisfaction of consumers precisely by stabilizing prices, reducing the incentive to strike for higher

wages, and adding a disincentive by pushing up unemployment. By contrast, the government’s policy of subsidies to workers in sensitive sectors such as transport bought only the most illusory kind of social peace. The problem with this strategy was that it tended to stoke up wage pressure by strengthening the bargaining position of labour. Clearly, both the Bauer and Fehrenbach governments hoped that it would be possible to limit such pressure by reimposing controls on prices, following the rapid inflation of late 1919. However, because of extensive smuggling and black marketeering, price controls were even less effective than they had been in wartime; and in any case, workers were beginning to appreciate the strength of their position. When government money was being earmarked for the reconstruction of the merchant marine, Erzberger had offered to include a clause in the legislation explicitly prohibiting the use of the subsidies for paying wage increases. But, as a spokesman for the shipyards pointed out, if the money were obviously coming from the Reich it would be almost impossible ‘to exercise restraint on unreasonable wage demands’: ‘Already the only thing we ever hear from the workers is: “But the Reich will pay for everything”, and their wage demands keep rising immeasurably.’ Such expectations were more or less confirmed in April 1920, when the Labour Ministry imposed a 50 per cent wage increase on the shipyards. In the wake of the anti-Kapp strike, there was a wave of strikes of a more purely economic nature. ‘Everyone else is striking,’ workers were heard to argue, ‘So why don’t we?’ The wage spiral was further accelerated by the system of collective bargaining and arbitration which had emerged from the revolution. Not surprisingly, the available figures for real wages point to a sharp improvement during the period of relative stabilization. Whereas for most of 1919 wages had been stagnant while prices had been rising, now in 1920, with prices stagnant, it was wages which rose (figure 7), as the not untypical figures for railway workers show.

The point is that this did not have any real political benefit. The government’s policy of boosting employment and real wages had been intended to diminish the radicalism of groups such as the shipyard workers. In practice, however, expanding the numbers and wage packets of such workers only served to bolster the position of the more radical elements in the unions and the works’ councils, to antagonize employers and hence to exacerbate industrial friction. In northern Germany, the showdown was not long in coming; for, whatever ill-conceived plans for a national coup had been hatched by the KPD leadership in Berlin, the ‘March action’ in Hamburg must be seen as the culmination of months of industrial friction.

91 Staatsarchiv Hamburg, Firmenarchiv Blohm & Voß 13, 11, Firmenleitung, 15 April 1920, 29 April 1920; National Archives, Washington, RG 59, 862.00/925, Stewart to State Dept., 19 April 1920.
92 National Archives, Washington, RG 59, 862.00/950, Stewart to State Dept., 18 May 1920.
93 See in general Bähr, Staatliche Schichtung in der Weimarer Republik.
94 On the March action, see Politisches Archiv des Auswärtigen Amts, Po. 5, No. 3, 11, Reichskommissar für die Überwachung der öffentlichen Ordnung, Denkschrift über die Märschunruhen im Jahre 1921.
Figure 7. Average weekly real wages of railway workers, 1919-1923
(1913 = 100)
Source: Zahlen zur Geldentwertung, p. 41

And yet it would be difficult to view the action as a serious revolutionary
threat. The workers were divided, with many non-Communists opposing
the action, while the police successfully dispersed the initial demonstration,
cleared the shipyards, and decisively won the ensuing shoot-out. It was
precisely the kind of confrontation which the employers had yearned for
since November 1918. In the aftermath, hundreds of workers who had
taken part in the action were sacked and 20 radicals on shipyard works
councils were purged. Although it is just one example of the kind of
conflicts which occurred in varying forms throughout German industry in
the period of relative stabilization, the March action does suggest that the
authorities had rather more political room for manoeuvre than they realized.

95 National Archives, Washington, RG 59, 862.00/1088, Stewart to State Dept., 4 April 1921; 1089;
11 April 1921.
96 Staatsarchiv Hamburg, Firmenarchiv Blohm & Voß 1368, Blohm & Voß to Norddeutsche Gruppe
des Gesamtverbandes deutscher Metallindustrieller, 31 March 1921; Niederschrift über die Verhandlungen
über die Wiederherstellung der Arbeiterchaft, 31 March 1921; Niederschrift über die Sitzung, 7 April
1921; Anlage zum Rundschreiben an die Norddeutsche Gruppe des Gesamtverbandes deutscher
Metallindustrieller: Betr. Befreiung der Betriebsratsmitglieder von der Arbeit, 27 May 1921; Blohm &
Voss 264, Blohm Aufzeichung, 20 June 1921; Norddeutsche Gruppe des Gesamtverbands deutscher
Metallindustrieller, Protokolle 27 May 1921; Blohm & Voß 485, Rudolph Blohm to Handelskammer
Hamburg, 7 July 1921; Arbeitgeber-Verband Hamburg-Altona, 8 July 1921; Handelskammer Hamburg
to Hamburg Wirtschaftsrat, 19 July 1921.
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It is by no means clear that the threat of revolution was as great in 1920/1 as it had been in 1918/9. Certainly, if one looks ahead to the far greater upheavals of the period of hyperinflation, it is hard to see that much was done for the long-term political stability of the Republic by postponing stabilization for a further three years.

V

Fear of unemployment was not the only factor which discouraged governments from stabilizing in 1920/1, however. Just as important, if not more so, was their fear of reparations. Annual reparations as scheduled by the London Ultimatum—2 billion gold marks plus 26 per cent of the gold value of German exports—implied a total annuity of around 3 billion gold marks. 97 At least 8 billion gold marks (and perhaps as much as 13 billion) were actually handed over in the period before the Dawes Plan: between 4 and 7 per cent of total national income. 98 Apart from the strain on the state’s finances discussed above, this also implied an acute international conflict of interests. If Germany were to run a trade surplus of 3 billion gold marks, there would have to be a drastic contraction of German imports and an expansion of German exports. But which of Germany’s trading partners would pay the price for this? If reparations were to be financed by borrowing, on the other hand, whose claims would take precedence—the recipients of reparations, or the new lenders? 99 Yet it does not necessarily follow from this that the German government was therefore right not to attempt to pay reparations. The question is not whether the transfer was sustainable, but whether the strategy adopted by the German government was the best way of convincing the Allies that it was not.

‘Economic revisionism’ was supposed to put pressure on the Allied economies by promoting a flood of German exports, opening a gap between German prices and world market prices which would make German goods irresistible abroad, and foreign goods unaffordable in Germany. This had worked in 1919. But the differential was wiped out in the relative stabilization of the exchange rate in the spring of 1920. As Felix Deutsch noted:

Our good fortune in the midst of misfortune is our poor currency, which enables us to export on a large scale. If the currency improves externally at a rapid rate, as we saw a few months ago, our exports stop entirely, and our industry is ruined. 100

This explains why the Economics Ministry took the step of intervening against the mark between March and June 1920, buying substantial amounts

97 Maier, Recasting bourgeois Europe, p. 241f.; Kent, Spoils of war, pp. 132-8. Webb suggests that a total of 4 billion gold marks was being demanded to cover occupation costs and ‘clearing’ payments: Webb, Hyperinflation, p. 104f.


99 Fischer, ‘Die Weimarer Republik unter den weltwirtschaftlichen Bedingungen der Zwischenkriegszeit’.

100 von Specht, Politische Hintergründe, pp. 30, 43n.
of foreign currency to limit the appreciation of the mark. Yet even the very sharp depreciation of the mark against the dollar between May and November 1921 did not bring about a repeat of the late 1919 ‘fire sale’ (Ausverkauf). True, the available export statistics point to a 35 per cent increase in the gold mark value of monthly exports in the year after May 1921, while annual figures suggest a two-thirds increase of exports in volume terms. Graham’s calculations for 43 categories of commodity also point to increases in exports. But at the same time imports grew even faster. This was of critical importance, since only a trade surplus would have had the intended effect of exerting economic pressure on the Allies. Estimated annual figures point to a trade deficit of around 690 million gold marks in 1921 and over 2,200 million in 1922, compared with a tiny surplus in 1920. Monthly figures provide a more precise record: the trade gap widened between May and September 1921, narrowed to record a small surplus in December 1921, and then widened again to reach a peak in July 1922 (figure 8). The figures for trade volumes tell the same story, but suggest an even more dramatic widening of the deficit after February 1922, despite the fact that by this stage the proportion of semi-finished and finished goods had risen to one-third of all imports. And these figures may actually understate the extent of the trade gap. While Economics Ministry officials continued to claim that exports were being underestimated and that the deficit in 1922 was negligible (claims which have misled later historians), there was ‘complete consensus’ in the Reich Statistical Office ‘that the balance of trade deficit was being significantly underestimated’.

In other words, contrary to the predictions of the proponents of economic revisionism, the trade deficit widened at the times of most rapid nominal exchange rate depreciation and narrowed when the mark stabilized. Precisely when Germany was supposed to be putting the reparations collectors under pressure by flooding their markets with cheap German exports, it

104 There are, as usual, a number of quite different calculations to choose from, beginning with Keynes’s estimates in Collected writings, XVIII, pp. 48, 54; Statistik des Deutschen Reiches 317, p. 5; Laursen and Pedersen, German inflation, pp. 68 ff., 83, 89-91; Holtfrerich, Inflation, p. 212; Webb, Hyperinflation, p. 91; and Feldman, Great disorder, p. 600 (citing estimates by R. Pilotti for the Reparations Commission). Though all clearly indicate an increased deficit in 1921, Holtfrerich, Webb, and Feldman follow the Statistik des Deutschen Reiches in arguing that there was a near balance in 1922. However, the relevant figures arrived at by converting volume figures into 1913 unit values using the customs schedule of 1913, which makes no allowance for the ‘dumping’ of German exports. My own calculations based on monthly data for value as well as volume suggest that the deficit grew to around 2 billion gold marks in 1922, close to the estimate given by Laursen and Pedersen: Ferguson, Paper and iron, pp. 325 ff.
105 Data on the structure of trade in Hentschel, ‘Zahlen und Anmerkungen’, p. 96; Laursen and Pedersen, German inflation, pp. 99-107; Bresciani-Turroni, Economics of inflation, p. 194. Clearly, volume figures are dominated by bulky items such as coal and grain and are therefore not the same as constant-price figures. But the monthly data for trade values in gold marks also show a substantial deficit in 1922: see Ferguson, Paper and iron, p. 237.
was in fact relieving the pressure on them by providing a buoyant market for their exports. This may well have been good for the world economy, helping to lift it out of a slump which might otherwise have become a depression, but it was wholly counterproductive from the point of view of German revisionism.

Figure 8. Monthly trade values (million gold marks), 1919-1923

*Source:* Bresciani-Turroni, *Economics of inflation*, p. 448; *Monatliche Nachrichten über den auswärtigen Handel Deutschlands*

The reasons for the unexpectedly large German trade deficit can be summarized briefly. Hostility to German exports abroad may have been a factor, but the real problem was that although in nominal terms the mark clearly depreciated against the other major currencies, in real terms (allowing for changes in relative prices) there was no significant improvement in German competitiveness. This reflected the low level of British and American prices, continuing foreign speculation in the mark, and more rapidly adjusting German domestic prices and wages.

In short, the idea, so influential at the time, that continuing depreciation

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109 Holtfrerich, *Inflation*, pp. 206-20. Holtfrerich estimates that, if Germany had adopted deflationary policies, imports from the US would have been reduced by 60%, and imports from the UK by 44%. In effect, he suggests, German inflation averted a world depression of the sort experienced a decade later. This point is hard to reconcile with his assertion that inflation was the only way to persuade the Allies of the need for revision after 1921.
111 This had been predicted by the Social Democrat economist Hilferding: 'With the increase of the issues [of notes] the balance of trade necessarily becomes passive. In effect, the issues increased internal prices, and that stimulated imports and impeded exports', quoted in Bresciani-Turroni, *Economics of Inflation*, p. 44n; Maier, *Recasting bourgeois Europe*, p. 251.

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would help Germany to avoid paying reparations was fundamentally misconceived. If anything, by providing a market for British and American distress goods, it had the reverse effect. Inevitably, this begs the question: would not a policy of stabilization have been more effective in exerting pressure on the Allies, in that it would, if nothing else, have dampened German demand for imports? The question is not easily answered; but the experience of the period after 1930, when deflationary policies drastically reduced German imports, suggests that it might have been. After all, reparations survived the crisis of 1922/3, to be restored, rescheduled but not reduced, in 1924. They were dead and buried in 1932. Of course, we cannot say for sure whether France would have acted differently, faced with a Germany which had stabilized its finances in 1920. Perhaps the political deadlock over reparations would still have precipitated the French occupation of the Ruhr, a shock which would have scuppered any conceivable counter-inflationary strategy. The most that can be said here is that the policy actually pursued by Germany was less likely to exert pressure on Britain and the United States than a conceivable policy of stabilization.

VI

It is thus clear that there was an economic alternative to the inflation, and that the political consequences of the alternative could well have been preferable. The necessary steps were not taken to end inflation in 1920 because contemporaries exaggerated the economic and political damage they would do, both domestically and to Germany's international position; and because they underestimated the dangers of continuing inflation. These included economic damage, taking the form of misinvestment and overcapacity in industry and perilous weakness in the money and capital markets; social trauma, not only material but cultural, in the sense of a crisis of the values of bourgeois society; political weakness, visible in the fragmentation of (non-Catholic) bourgeois politics; to say nothing of an international crisis in which Germany failed altogether to secure a reduction in the total burden of reparations. This was doubly unfortunate, first, because the legacy of the inflation fatally circumscribed subsequent policy makers; and secondly, because subsequent experience shows how successfully such alternative policies might have worked.

The influence of the inflation on subsequent economic policy cannot be overestimated. Numerous possible alternatives to the policy of deflation pursued between 1930 and 1932 have been suggested by historians opposed to Borchardt's line of argument. The Germans, so it has been argued, could have accepted loans from abroad, regardless of the conditions attached to them; they could have ignored Germany's international obligations and floated the Reichsmark; they could have financed job creation by increasing

112 Ferguson, Paper and iron, pp. 408-62.
113 Holtfreich, 'Discussion', p. 159.
government borrowing (or cutting spending on agricultural subsidies), or via the banking system, i.e., by additional (and implicitly illegal) money creation. But there are two decisive arguments which can be advanced against these ‘alternatives’. First, even the most radical contemporary schemes would not have significantly improved the economic situation. Secondly, international and domestic constraints made their adoption impossible. Of these, perhaps the most important was the belief that any attempt at deficit finance or devaluation would lead to a second great inflation. In theory, it would have been possible for a government before 1933 to suspend reparations payments, float the mark, increase public spending, and print money: after all, that is more or less what had happened in 1922–23. But the result then had been hyperinflation. This fear meant that the slightest hint of an ‘alternative’ policy tended to accelerate the flight of foreign capital, so tightening the monetary and fiscal vice. The earlier crisis decisively limited room for manoeuvre in the later crisis.

In order to set the Weimar crises in a broader perspective, it is worth also making a tentative comparison of stabilisation in the early 1920s with stabilisation in the late 1940s. Why did the West German economy emerge from this second postwar crisis so much more successfully than from the first? At first sight, the problems were similar, if not greater: it took three years rather than five to reform the currency, but in that time the degree of economic dislocation was greater than it had been for most of the post-1918 period: indeed, output was lower, and the collapse of the currency set in much more rapidly. The view that a combination of Marshall Aid, currency reform, and deregulation brought about an economic ‘miracle’ after 1948 is too simplistic. Marshall Aid was preferable to reparations, to be sure, but it was relatively limited in scale compared with the large influx of private American capital there had been in 1919-22. In a number of respects the currency reform and asset revaluation legislation were little different from those of 1924, with notable similarities in the surge of inflation in the first six months of the new money. On the other hand, a purely structural interpretation of postwar recovery, whether it emphasizes the strong postwar capital base or plentiful labour supply, underestimates the influence of certain fundamental differences in stabilization

115 Lee, ‘Policy and performance’.
117 Borchardt and Ritschl, ‘Could Brüning have done it?’.
policy. First, the public sector was effectively prevented from running deficits and indeed ran surpluses in 1948/9, allowing it to stimulate saving rather than inflation. Secondly, the Bank deutscher Länder was equipped with a far wider range of powers than its Weimar predecessor: it could not only employ the discount rate, but could also conduct open market operations (a reform which dated back to 1933) and impose minimum reserve requirements. These devices ensured that credit expansion was brought under control in 1948/9. Thirdly, a quite different policy was adopted on the balance of payments: faced with persistent trade deficits, the authorities maintained exchange controls, but devalued the currency formally in September 1949. In these ways, stabilization policies were superior to those of the early Weimar years. Indeed, it might be said, they provide a ‘model’ for what ought to have been done in 1920.

Yet it would be unhistorical simply to conclude that what Weimar needed were the policies later adopted by Bonn. It was not just that Bonn had ‘learnt from the mistakes’ of Weimar. In the period after 1945, the authorities were not entirely democratically accountable under the terms of occupation. They were thus able to pursue price stabilization even when it resulted in higher unemployment (the docility of postwar German labour should not be exaggerated). The political context was quite different after 1918. And although a few economists did advocate the right policies in 1920, the striking thing is how completely isolated they were. Moreover, even if more ‘experts’ had accepted the rationale of an early stabilization, it is extremely hard to see how such a policy could have been implemented. Too many economic interests were too well represented in the host of competing institutions which made Weimar policy for an even slightly deflationary policy to have stood a chance of success. To take a single example: Witt argues that Erzberger’s tax reform programme was watered down by opposition from the bourgeois parties in the Reichstag, the Reichsbank, and economic interest groups, and then ‘sabotaged’ by business tax evasion. But as Feldman has demonstrated, the continuing deficits after 1919 owed as much to Social Democrat demands for higher wages, higher food subsidies, and higher spending on housing. Ultimately, it was only possible to reform the currency in 1923/4 by using the presidential powers to rule by decree. Indeed, even if those powers had been used in 1920 to implement the alternative policies suggested here, there is no guarantee that stabilization would have lasted once parliamentary government resumed. But that is not to say that there is no point in thinking about a counterfactual economic policy, simply because it was politically impossible;


123 Balderston, ‘Links between inflation and depression’, p. 177.


125 Ibid., p. 468.

126 Ibid., p. 473.


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or that, given the extreme politicization of the Weimar economy, such a separation of the economic from the political is difficult to imagine. It is of real historical importance that the arguments which contemporaries advanced against stabilization were wrong. They exaggerated the socio-political benefits of maintaining full employment at the price of price stability. And they exaggerated the diplomatic benefits of currency depreciation.

The point of considering economic policies which would have been better is not to condescend to the past, but to understand better what did happen. What is condescending to the past is to suggest that people at the time had no free will; that they were the helpless ‘objects’ of impersonal ‘structural’ forces over which they had no control. This is the danger of deterministic models: whether they explain the inflation in terms of external or internal distributional conflicts, they tend to understate the importance of political decisions. And simply because political decisions in the early years of the Weimar republic were reached by an exceptionally tortuous process does not mean they somehow reached themselves. Those involved in the debates and decisions on fiscal and monetary policy in 1920 would not have bothered had they been so impotent. Perhaps the crucial point is that the net result of all their proposing and disposing, even if it was not exactly what any individual would have wanted, was democratically determined. The fact that it was economically misconceived and avoidable deserves more attention than it has hitherto received, even if the implicit conclusion is an uncomfortable one—that it would have been better if Germany had adopted a more authoritarian system of government in 1920, rather than 13 luckless years later.

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