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Enduring lessons from the German hyperinflation 1923-2023

Ignazio Angeloni: The Weimar inflation a century ago is a unique event with unrepeatable characteristics. But it contains elements of all inflations of all times

A century is enough to wipe out a civilization, render cities and nations unrecognizable, and extinguish, with very few exceptions, all the earth's inhabitants. But it has not been enough to erase from the deep sensibilities of the German people the mark of one of the most traumatic experiences in their history: the hyperinflation of the Weimar Republic, the culmination of which marks its centenary on 15 November this year.

We find traces of it in some typical German traits: the aversion to change, seen as a harbinger of instability; frugality, felt as a safe haven in adversity. What Costantino Bresciani Turroni, economist and Italian representative on the War Reparations Commission, wrote in the 1930s still holds true: "It is easy to understand why the experience of the sad years between 1919 and 1923 always weighs like a nightmare on the German people."

The young republic had just emerged from the lost war, in which the combination of Prussian militarism and the sprawling imperialist ambitions of Austria-Hungary: a state without a unified identity, an egg with two yolks, as Christopher Clark wrote in his masterful essay on the origins of the First World War (The Sleepwalkers; HarperCollins, 2012).

After the return of the soldiers from the battlefields and the failure of the communist revolution of Klaus Liebknecht and Rosa Luxemburg, killed in 1919 by the infamous Freikorps, paramilitary units that later merged into Adolf Hitler's SA, the young republic had a chance to find its own golden age. Political and artistic freedom flourished despite the hardships: Kandinsky and Ernst in painting, Brecht and the Manns in literature, Gropius in architecture, the physicists Heisenberg and Born, and many others expressed a European intellectual vitality that Nazism would eradicate or cause to emigrate forever.

Germany's inner monetary disaster

As in any conflict, the war economy had created inflation. But it was a limited phenomenon, which could still be controlled. Bresciani Turroni shows with data and arguments (The Economics Of Inflation: A Study Of Currency Depreciation In Post War Germany; 1914-1923; George Allen & Unwin, 1937) that after the armistice of Compiègne (November 1918) and before the Treaty of Versailles (June 1919) and the London Ultimatum (May 1921) imposed on Germany the onerous war reparations that John Maynard Keynes would stigmatize in The Economic Consequences of the Peace (McMillan; 1919), the seeds of the monetary disaster were already being sown internally.

Several factors conjured to that outcome. The sluggishness and weakness of the government, amid social unrest and fears of communist revolution in the North and fascist revolution in Bavaria; the interests of industrial groups and speculators who profited from the inflation in foreign currency and food markets; and, above all, the nefarious influence of wrong economic ideas. The latter concerns us most today because their influence can be repeated. True, the Weimar inflation is a unique event with unrepeatable characteristics. But like a laboratory in which extreme conditions help to understand the nature of matter, it contains, in essence, elements of all inflations of all times.

The Weimar political class and its central bank, the Reichsbank (whose president, Rudolf Havenstein, as in a Greek tragedy, was to die on 20 November 1923, the very day of the stabilization of the Reichsmark), were prisoners of two ideas, as wrong as seemingly undeniable. They are still worth reminding, so that they can be recognized and avoided in the future.

The first idea is the so-called “real bills doctrine”, stating that money creation is not inflationary if it finances productive activity, because an equivalent production accompanies the creation of money. It is easy to understand the appeal of such a theory to industrialists and speculators interested in financing of their activities despite runaway inflation. The “doctrine” is flawed because it imposes no limit on the money supply and the price level.

But even that idea would not have done much harm had it not been combined with another one, that the American economist James Tobin would refute years later, calling it “post-hoc-ergo-propter-hoc:” the theory that between two successive economic events there must necessarily be a causal relationship. Instead, the relationship may reverse, with the later event causing the earlier one.

The devaluation of the German Reichsmark caused the impoverishment of the middle classes

During the war, adjustments in the value of the Reichsmark against the U.S. dollar or the British pound tended to follow changes in its domestic value (in terms of consumer goods). In the post-war period, the opposite began to happen: the devaluation of the Reichsmark often anticipated and even exceeded the rise in domestic prices, and even more so the increase in wages, resulting in real depreciation of the exchange rate and the impoverishment of the middle-class.

As inflation rose, and retail prices tended to lose meaning, the only objective reference for domestic price setters being the price of the Reichsmark on the London and New York stock exchanges. The mistake of the politicians and the central bank was to believe that, therefore, the exchange rate depreciation caused prices to rise. And that, as a consequence, the central bank had to accommodate the rise in money demand to avoid the collapse of the economy (today we would call it a “recession”). Since the exchange rate was dragged down also by war reparations, it was both easy and politically attractive to conclude that the victorious powers were causing inflation in Germany through their unbearable war reparations.

Could Germany have paid the reparations and at the same time avoid economic disaster? Keynes has denied it, with his usual rhetorical force. In a recent essay, the Italian historian Alessandro Roselli (Hyperinflation, depression, and the rise of Adolf Hitler; Economic Affairs, 2021) leans toward the opposite thesis. Be that as it may, as late as August 1923, three months before the stabilization of the Reichsmark and his death from a heart attack, while prices rose twentyfold in a single month, Reichsbank president Havenstein reiterated that inflation came from abroad (today we would call it “imported inflation” or “supply shock”) and that the central bank had to accommodate it.

The pivotal role of Hjalmar Schacht

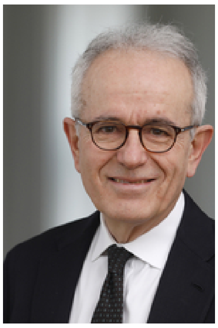
In the drama of the German people at that time stands the figure of Hjalmar Schacht, one among the outstanding central bankers in history, whose reputation was not undermined even by his later partial acquiescence to Nazism. Appointed by the newly appointed chancellor Gustav Stresemann as “Commissioner for Currency,” i.e., de facto replacement of the Reichsbank president, and relegated to a temporary office, a basement formerly used as a broom closet, Schacht knew that only decisive action with an immediate and powerful psychological impact could stop inflation and devaluation together and save the economy.

He waited until November 20, when the Reichsmark’s value hit a psychologically meaningful value: one-millionth of a millionth of the prewar gold standard. At that point, Schacht cut twelve zeros and announced that the central bank, of which he would officially become president after Havenstein’s death, would no longer finance the government. The old Reichsmark paper was then worth a thousand billionth of the new currency, the Rentenmark, the supply of which was carefully rationed; for good measure, convertibility would be allowed in the following year, after the success of the reform was secured. The effect was miraculous. Prices and exchange rates stabilized; the state budget returned to balance; previously unavailable foodstuffs reappeared in the stores. Germany regained relative prosperity that would last for years, until the Great Depression led to Nazism.

Today, as these events still disturb the sleep between the Rhine and the Oder, it is not pointless to remind their lessons. Inflation always has many causes – a war, a change in import prices, a health or an energy crisis. But it cannot persist without monetary accommodation. Once it takes hold, it is always difficult to identify its causes, in the confusing sequence of events, each of which can be interpreted as the consequence of another. There always exist plausible reasons and more or less conflicted advisors arguing that the central bank should delay the countermeasures. In the end, however, there is no alternative to monetary policy to stop it.

As Lord D’Abernon, British Ambassador to Berlin from 1920 to 1925, a relentless critic of the German rulers and the source of much of our knowledge of that period, wrote: “In one way or another, inflation is a drug. Ultimately, it is fatal, but first, it helps its constituents through many difficult times.”

Ignazio Angeloni is SAFE Senior Fellow, part-time professor at the Robert Schuman Center of the European University Institute, and a former member of the ECB Supervisory Board.



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