

# **WHEN MONEY DIES: THE NIGHTMARE OF DEFICIT SPENDING, DEVALUATION, AND HYPERINFLATION IN WEIMAR GERMANY**

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Inflation, like most society-wide monetary happenings, is always complex and often incompletely grasped. At least this is true of its causes; of its effects, most of all its social effects, there is now little doubt. We learned much about inflation during the twentieth century, when the advent of permanent fiat money made hyperinflation possible for the first time. But as this book shows, the infamous German hyperinflation of 1923 was poorly understood by those who lived through it. And whatever we understand now, the past several years, and in particular the past few months, have demonstrated that we still often ignore what we know. *When Money Dies* shows what happens when reality reasserts itself. It's not pretty.

This classic study by Adam Fergusson, first published in 1975, thus has new resonance. Whether and to what extent we face the same fate as the Germany of 1923 we will discuss later. One key to understanding Fergusson's history is that a society, or at least some societies, can absorb a lot of punishment and keep functioning. The author points out that for half a decade after 1918, looking at German diaries, newspapers, and diplomatic dispatches, a common theme was that things could not go on "like this" any longer. Yet they did, and they got worse, month after month, year after year. Many Germans, Fergusson says, became convinced "that because conditions had been getting worse for four years they could go on getting worse forever." The lesson is that things that once seemed impossible can easily become the new normal, and there is rarely any obvious fix.

As with most modern inflations, the process began some time before it spun out of control. It started during World War I, when the German government decided that borrowing, not taxation, would finance the war. Borrowing in the form of war loans from the populace constituted sixty percent of German spending on the war, at a time when a gold mark was, by iron definition, equal to a paper mark, and any variation was inconceivable. The Bank Law of 1875 had required currency to be backed

one-third by gold and two-thirds by loans to adequately-capitalized borrowers (i.e., if I understand this correctly, fiat money was limited to being sent into circulation by borrowing by those who could repay). During the war, gold redemption was suspended, but more important for inflation, newly-created loan banks were allowed to simply create money by first printing it, then lending it to practically anyone who asked. Moreover, and most important, limitless fiat money was created by having the Reichsbank accept government securities as security for loans to the government and others—in essence, bootstrapping the money supply (an early form of quantitative easing). Today, of course, United States government securities are regarded as risk-free, and presumably German government bills were so regarded as well, though that's not the way it turned out. But this system removes any limit to the amount of money that can be created by government mandate.

The effect of this increase in paper marks in circulation was inflation. This seems obvious to us today. But it wasn't to the Germans—not to the average person, and not to banking experts or the government, either. Hard as it is to believe, almost nobody, and nobody in charge, recognized at the time that what created inflation was increasing the money supply. Today we cite Milton Friedman, "Inflation is always and everywhere a monetary phenomenon." But that Friedman said it, and we remember it, implies that truth was not always recognized. In postwar Germany, all those responsible for the government's responses, politicians and bankers, believed that the problem was not that the mark was losing value through increased supply, rather that it was depreciating against foreign currencies due to Germany's postwar economic struggles, most of all crushing reparations demanded by the French. People thought that goods were becoming objectively more dear, not just subjectively, so their prices were rising. This belief held at the highest levels of government, where Rudolf Havenstein, the president of the Reichsbank, held that his most important duty was printing more money, since, after all, the people clearly needed it to make purchases, and that could only be done, in those days, with physical money. Naturally, this only made the problem worse. But since stock exchanges were closed, foreign exchange rates were not published, and shortages and chaos also raised prices, the real source of inflation was opaque. In a vicious circle, monetary velocity sped ever higher, further increasing inflation, since nobody

wanted to hold cash that would quickly devalue, instead spending it as quickly as possible, preferably on something that would hold value. And the law permitted what were, in effect, private currencies, further exacerbating the increase in the money supply.

Fergusson narrates the gradual descent to hyperinflation, through 1922 and 1923, month-by-month, blow-by-blow. He extracts the flavor of the time through German diarists, who grasped what was happening, but not why. Tellingly, Germans first assumed the value of their war loans, still owed by the government, was secure, and were aghast when it became obvious that what was formerly a small fortune was not enough to live on anymore. But that was merely a small element of the pain and confusion. To some observers, Germany's economy seemed in great shape, because its heavy industry, geared to exporting, boomed immediately after the war, in part because of the mark's weakness. As a result, and because of their tight organization, wage workers suffered little initially, since employment was high and wages kept pace with inflation, due to the threat of work stoppages. By the end, though, wage workers suffered too. For different reasons, the rural populace also did not suffer much at all—yes, their war loans might have become worthless, but they had food and shelter, both rich and poor. (The rural populace appears very little in this book, except as the object of distrust from city dwellers for refusing to sell food for worthless paper; I am sure there are detailed studies of the country dwellers, which perhaps give a more nuanced picture.) It was the traditionally silent middle and upper-middle classes, the backbone of the society, who suffered.

The people did what they could to secure their positions, even as those positions eroded daily. The stock market rose as money was dumped into anything that seemed it might have tangible value. The purchase of foreign currency allowed hedging, since the mark depreciated continuously against all foreign currencies. Soon enough, average Germans thronged all the shops, buying anything for sale that might hold its value. And as things fell apart, city dwellers had to sell anything they had in exchange for food—profiting those who had food to sell. Often these were speculators sharp enough to profit by, for example, borrowing huge sums from the government, immediately converting it into foreign currency, then, after a few weeks or months, re-converting

into a vastly greater quantity of marks, repaying the government loan, and using the profits to buy and resell goods.

The inevitable impact of this was social corrosion, as every man looked to himself. The great industrialists, best able to both move large amounts of capital and engage in cross-border transactions, lined their pockets. (The now-forgotten Hugo Stinnes, once the greatest magnate of Germany, gets a lot of play in these pages. He's forgotten mostly because he died, young and unexpectedly, in 1924, so he played no role in later German history.) Those with dollars or other foreign currency to spend lived like kings, eating and drinking at fine restaurants while thin and hungry men, not long before the social elite, passed bitterly by. Middle-class apartments emptied as books, pianos, and furniture were exchanged for food. Petty crime soared and political stability plunged. Fergusson does not discuss the political turmoil in detail, other than to note that the left-wing and right-wing parties both benefited from the chaos and dissatisfaction, leading, among other events, to the Beer Hall Putsch in November 1923. But there was plenty of political turmoil, and let's not forget, putting down Communist revolts by force had been necessary only a few years before, so the political fabric was still fragile.

Much else was happening in 1922 and 1923—for a time, Germany pulled together during the occupation by the French of the Ruhr. But the general path, financially and socially, was clearly downwards, and rapidly. The government tried to plug the ever-increasing gaps in its budget, and meet French reparations demands, by taxation—leading first to tax evasion, and then to failure to collect any but a fraction of the value taxed, as inflation eroded tax receipts to nothing between the passing of a law and the collection of the tax. But the government, perfectly aware of the problem, though not of its roots, refused to take any real action. They did not stop printing money, nor did they stop various forms of subsidies that the government could no longer afford. Politicians and bankers were caught between two stones: aware that reversing inflation, if they could, would cripple German industry, resulting in massive labor unrest and likely chaos, but also aware of the deleterious effects of the inflation on the rest of the German populace. In essence, to the extent there was any coherent policy, the government tried to steer a non-existent middle path, hoping to muddle through, while looking

for foreign help to stabilize the currency through loans, which were not forthcoming. As with most middle paths, this accomplished nothing.

By September 1923, though, with inflation accelerating to inconceivable speed, the desperate government took measures to suspend the constitution and passed laws to confiscate foreign currency, gold and other precious metals, and increase the penalties for evasion. Warrantless house searches were authorized and “incitement to disobedience” led to prison. City dwellers began organizing expeditions to loot the countryside. The government tried halfhearted schemes to issue money backed by agricultural goods such as rye or mortgages on agricultural land. None of this had any effect at all on the core problem, which is that everyone did what he saw that he had to do. Whatever respect for the government was left disappeared when its resistance to the French in the Ruhr crumpled and “[c]ontempt for the Republic and its servants became almost universal.”

So what solved the problem, given that something that can't go on forever, won't? In essence, an agreement by everyone to accept their losses and pretend that things were normal again, through the device of a new currency, the Rentenmark, brainchild of Hjalmar Schacht, the new Commissioner for National Currency. One Rentenmark, put into circulation in October 1923, was again equal to one gold mark, and Rentenmarks were put into circulation at the point where one gold mark precisely equaled a trillion paper marks, for easy figuring of conversion. The Rentenmark was backed not by gold, which had all disappeared from government coffers (most of it gone to the French), but by mortgages on landed property and bonds on German industry. (I don't really understand this. It appears that money was put into circulation by those with property borrowing money using their property as a guarantee, such that the amount of currency was limited by the value of those properties, and the value of those properties acted as a type of fixed index against which the currency could be valued, though not exchanged.) The effect of this conversion was, however, to eliminate all assets denominated in paper marks, which mean that savings were now completely gone, with no hope of return, as were all debts based on paper marks—whether the debtor was the government, as with war loans, or a business, or a private individual.

The Rentenmark was a collective delusion, however. It is not clear how much this was understood at the time; as with inflation being a monetary phenomenon, they understood less than we do. The mortgage “guarantees” were essentially illusory, yet the Rentenmark’s value held steady, because the populace either willed it to be so, or did not really understand. In fact, the Rentenmark was not precisely legal tender, and not convertible into any hard asset. Paper marks and private currencies continued to circulate and be printed, on a reduced scale, though. On the positive side, Schacht ensured some degree of confidence in the new currency by forbidding government borrowing through central bank discounting of government bills, which had been the major initial cause of the hyperinflation. Regardless of the precise mechanism, things began to return to normal, because of the Rentenmark.

The new normal was not like the old normal, though. Social ruptures are hard to cure, and when they are cured, the new society is much different. Trust was in short supply. No surprise, there was a lot of irrational thought and scapegoat-seeking, and again no surprise, much of this was directed against the Jews, whom most people viewed as in some uncertain way responsible. Some Jews did profit, of course, having liquid assets and cross-border connections, but so did many non-Jews, yet blame attached to Jews in general, not specific Jews. (The peasantry, unwilling to take paper marks for food, called them “Jew confetti.”) Many people to whom poverty had been a mere abstract concept were now desperately poor with no path to get back their social status. Of course, not all societies are equal, and Germans are, or were, much better at recovering than nearly any other society in history. Various laws were passed to try to offer a few pfennigs to those with worthless mortgages and bank accounts, and to adjust taxes, all of limited real benefit to the populace. It was a hard road, made harder by many businesses shuttering and unemployment soaring, since businesses had artificially expanded during times of distorted credit and foreign sales based on the weak mark. Nonetheless, the economy strengthened, and continued strengthening for a few years—until the Great Depression. But that is another story.

So could this happen here? Probably not, no matter how much money we borrow or print to cover our government’s sins, as long as all currencies are fiat currencies and the dollar is the world’s reserve currency. As

with the Rentenmark, though, continued faith in fiat currency is in large part a collective delusion. If that ever fails, probably from some collapse in faith in both the government and the future, perhaps combined with a new reserve currency, all bets are off. In the modern world, too, it's not necessary to run physical printing presses (thousands of which worked around the clock for the Reichsbank in 1923); infinite money can be created by pushing a button, and velocity accelerated to hyperspeed by the internet and credit cards. What a hyperinflation would look like in a modern, advanced society, I don't know. That Zimbabwe has experienced a recent hyperinflation is unlikely to lend us much of a clue. But I do know that we're not Germans, and our social cohesion is already on the ropes, so our society would likely fracture permanently, not weld itself back together like the Germans.

In fact, such a scenario is the backdrop for Lionel Shriver's excellent dystopian *The Mandibles*, where a new global currency backed by commodities, similar to John Maynard Keynes's proposed *bancor*, underwrites a new Chinese hegemony. In that book, the United States can do nothing, since it has become a stupid stew of irrational and hate-filled identity politics where the ruling classes reject any attempt at objective excellence and achievement and insist that their failures are due to racism and wreckers. A silly fantasy, though, of course, since we know that such a thing could never happen here. We know that only an idiot could read history and conclude that an unstable, unaccomplished society run on an extractive, tribal basis is the natural state of humanity, and only a very bad person would let himself see that lately quite a few people in America seem very eager to turn America into such a society.

Perhaps the key lesson to take away from this book is that in any society experiencing massive economic trouble, those tasked with fixing it, no matter how earnest and hardworking, are almost always incapable not just of fixing the problems, but understanding them. That's true not just in economics, but in every area of life in a complex modern society, even one cohesive and competent, even more so one fragmented and anti-reality. Thus, in every crisis, every man must look to himself and his family, not hope for safety and stability from above. If he relies on those in charge, sooner or later, he's going to be disappointed, perhaps fatally so. Maybe it won't be hyperinflation here, but it'll be something.