When Money Dies

Brother, can you spare a million marks?

By Adam Fergusson

From wise friends to obscure websites, we'd heard rumors that it exists. But tracking down When Money Dies, *the definitive 1975 text on hyperinflation in Weimar Germany, is another matter entirely. Amazon lists a copy for $2,500. The Library of Congress declares it on perpetual "internal loan." The publisher is out of business. But we eventually located Adam Fergusson in London, and he graciously gave* TAC *permission to condense his classic. Even in abridged form, its literary grace and historical insight are apparent. So too its modern relevance.*

THE AGONY OF INFLATION is similar to acute pain—demanding complete attention while it lasts; forgotten or ignorable when it has gone, whatever scars it may leave behind. Some such explanation may apply to the strange way in which the remarkable episode of the Weimar inflation has been divorced from contemporary incident.

This is not an economic study. This is a morality tale. It goes far to prove the revolutionary axiom that if you wish to destroy a nation you must first corrupt its currency. Thus must sound money be the first bastion of a society's defense.

In 1913, the German mark, British shilling, French franc, and Italian lira were all worth about the same, and four or five were worth about a dollar. By 1923, it would have been possible to exchange a shilling, a franc, or a lira for up to 1,000,000,000,000 marks, although no one was willing to take marks for anything.

The inflation was so preposterous that the story has tended to be passed off more as a historical curiosity than the culmination of economic, social, and political circumstance of permanent significance. It matters little that the causes of the Weimar inflation are unrepeatable, that political conditions are different, that it is almost inconceivable that financial chaos would again be allowed to develop so far. The danger to be recognized is how inflation, however caused, affects a nation: its government, its people, its society.

If what happened to the defeated Central Powers in the early 1920s is anything to go by, then the process of collapse of the trusted medium of exchange, the currency by which all values are measured, by which social status is guaranteed, upon which security depends, and in which the fruits of labor are stored, unleashes such greed, violence, and hatred, largely bred from fear, as no society can survive uncrippled.

Certainly 1922 and 1923 brought catastrophe to the German bourgeoisie, as well as hunger, disease, destitution, and sometimes death to an even wider public. Yet any people might have ridden out those years had they represented one frightful storm in an otherwise calm passage. What most damaged the morale was that they were the climax of unreality to years of unimagined strain.

To ascribe the despair entirely to inflation would be misleading. Undoubtedly, though, inflation aggravated every evil, ruined every chance of national revival or individual success, and produced the conditions in which extremists could raise the mob against the state. It undermined national resolution when simple want might have bolstered it. Partly because of its unfairly discriminatory nature, it brought out the worst in everybody. It caused fear and insecurity among those who had already known too much of both. It fostered xenophobia. It promoted contempt of government and the subversion of law and order. It corrupted where corruption had been unknown, and often where it should have been impossible.

Before 1914, the credit policy of the Reichsbank had been governed by the Bank Law of 1875, whereby not less than one-third of the note issue had to be covered by gold and the remainder by three-month discount bills adequately guaranteed. In August 1914, action was taken both to pay for the war and to protect the country's gold reserves. The latter objective was achieved by the simple device of suspending the redemption of Reichsbank notes in gold. The former was contrived by setting up loan banks whose funds were to be provided simply by printing them. The loan banks would give credits to business, to the Federal states, to the municipalities, and to the new war corporations.

Thus were the government's plans drawn up for financing the war—not by taxation but by borrowing, with the printing press as the well to supply both the needs of government and the credit demand for private business. Only when the war was over, with the veil of censorship lifted, did it become clear that Germany had met an economic disaster nearly as shattering as her military one. Within a few months of the Armistice, the elements were present for the most devastating monetary collapse that any industrialized nation has ever known. Her industrial resources and manpower heavily reduced, and hopelessly burdened with the insupportable weight of reparation payments, Germany was required to regain her feet in quicksands of her own making.

The state of the mark became the barometer both of international confidence in Germany and national despair. Before the war, it had stood at 20 to the pound sterling. At the end of the war, it stood at 43. Before the terms of the Treaty of Versailles were accepted in June 1919, a pound would buy 60 marks. But when December came around again, it would buy 185.

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"The delirium of milliards [i.e., billions]" was a phrase of Foreign Minister Walter Rathenau's coining. "The majority of statesmen and financiers think in terms of paper," he wrote. "They sit in their offices and look at papers … and on those papers are written figures which again represent papers. … A milliard comes easily and trippingly to the tongue, but no one can imagine a milliard. … Does a wood contain a milliard leaves? Are there a milliard blades of grass in a meadow?"

Rathenau diagnosed that delirium as an affliction not of the people in general—that was to come—but of those who were supposedly in control of the country's finances, who had raised the note circulation since the beginning of the year from 73 milliard marks to 80 milliard. The mark, at 310 to the pound in mid-August, had sped downwards to over 400 by mid-September, and was still going down.

The disease, the German financial world seemed to agree, was not containable without international goodwill and a significant relaxation of the obligations under the peace treaties. But Germany's politicians set about relieving the symptoms wherever possible. The prime minister of Bavaria submitted a bill to make gluttony a penal offense. A glutton was defined as "one who habitually devotes himself to the pleasures of the table to such a degree that he might arouse discontent in view of the distressful condition of the population." It was proposed that such a one "may be arrested on suspicion, and punished by imprisonment and/or a fine of up to 100,000 marks for a first offense." The bill—reminiscent of an Austrian move to tax anyone who gave a luncheon or a tea party—was never enacted. It was indicative, nonetheless, of the offense caused by German profiteers and by the foreigners swarming to take advantage of the exchange rates, and the desperate lengths to which respectable politicians were being pushed.

Politics were becoming irrelevant: at Christmas 1921, the cost of living had become people's only concern. Since 1913, the price of rye bread had risen by 13 times; beef by 17. Sugar, milk, pork, and potatoes had risen between 23 and 28 times; butter had gone up by 33 times.

It was natural that people in the grip of raging inflation should look for someone to blame. In blaming the greed of tourists or the wage demands of labor or the selfishness of industrialists or the sharpness of the Jews, they were in large measure still blaming not the disease but the symptoms. A few of the financially sophisticated could be heard blaming the government, but a typical view was that prices went up because the foreign exchange went up, that the exchange rate went up because of speculation on the stock exchange, and that this was obviously the fault of the Jews.

By the spring of 1922, Germany was evincing many signs of national despair. The country's self-confidence ebbed away along with its prosperity, and as it did so, the moral degeneration of the nation and its institutions set in. Pessimism and restlessness grew as security, community spirit, and patriotism dwindled. Neither hatred of French militarism in the abstract and France in general nor a desire for revenge were enough to hold together what had been the most law-abiding people in Europe when the fabric of the nation was crumbling along with its ethical values, and the moral, material, and social ravages of inflation were immeasurably worsening the conditions of both.

Among some, the rebirth of the German soul, battered by war, hardship, and humiliation, was becoming something of an obsession. Not just the militarists of *Frontkämpfertag* and the academics of Königsberg but many of all classes began to long for a great leader: not a ruler of the type of the Kaiser, but one possessed of the attributes and Spartan values of the legendary figures of early Teutonic history. It was a longing Hitler fully understood. When a nation is falling apart, its old values challenged by new conditions, there are always elements who will seize on any means of cohesion.

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The rise in prices intensified the demand for currency, both by the state and other employers. Private banks could not meet the demand and had to ration the cashing of checks, so that uncashed checks remained frozen while their purchasing power drained away. It became impossible to persuade anyone to accept any description of check, and business came to a standstill. The panic spread to the working classes when they realized that their wages were simply not available.

Because the Reichsbank's printing presses and note-distribution arrangements were insufficient for the situation, a law was passed permitting, under license and against the deposit of appropriate assets, the issue of emergency money tokens, or *Notgeld*, by state and local authorities and industrial concerns when the Reichsbank could not satisfy needs for wage payment.

Before long, the tide of emergency money entering local circulation, with or without the bank's approval, contrived enormously to raise the level of the sea of paper. As the ability to print money privately in a time of accelerating inflation made possible private profits only limited by people's willingness to accept it, the process merely banked up the inflationary fire to ensure a bigger blaze later on.

The mark continued to plummet, but the chancellor would accept no connection between printing money and its depreciation. Indeed, it remained largely unrecognized in the cabinet, bank, parliament, or press. The *Vossische Zeitung* declared:

> The opinion that the flood of paper is the real origin of the depreciation is not only wrong but dangerously wrong. … Both private and public statistics have long shown that for the last two years the interior depreciation of the mark is due to the depreciation of the rate of exchange. … It should be remembered today that our paper circulation, although it shows a terrifying array of milliards, is really not excessively high…

British ambassador Lord D'Abernon described these remarkable views as "far from exceptionally retrograde," and in fact typical of enlightened Berlin opinion.

A liter of milk, which cost 7 marks in April 1922, by mid-September cost 26 marks. A Hesse professor lamented that month that teachers and men of science were no longer given the right to live, and many would probably die in the coming winter for lack of food and warmth. He feared that their sons, instead of following their fathers' careers, would by force of circumstances turn to manual labor: "Brains no longer have a marketable value. The result can only be a catastrophe for Germany and the downfall of civilization in central Europe, if not, indeed, the whole world…"

The suffering was acute, although worse was to come. Figures issued by the chief burgomaster of Pankow for 1922 showed that nearly 25 percent of the children leaving school were below the normal spread of weights and heights, and 30 percent were unfit to work for reasons of health. "Want," said the burgomaster's report, "is gradually strangling every feeling for neatness, cleanness, and decency, leaving room only for thoughts of the fight with hunger and cold."

The gold value of money in circulation, equivalent to nearly $300 million before the war, had by November fallen to $20 million. The more notes were printed, the lower the value fell. How the business of the country could be carried on with so small an amount of real currency mystified observers and accounted for mounting pressures on the bank to go on printing. Notes were held for as short a time as possible. Private-accounts checks were hardly accepted. Anyone receiving money for goods quickly converted it back into other goods, and the money never stopped moving, doing the work of ten times the amount moving a tenth as fast.

The Reichsbank had proclaimed, and was now carrying out, a program of unlimited printing. More and more presses were employed, and by December the amount issued was limited only by the capacity of the presses and the physical fatigue of the printers. Lord D'Abernon reported to London: "The exchange market and the Reichsbank are like a runaway horse with an incompetent rider—each aggravates the folly of the other."

"By the end of the year," said Erna von Pustau, "my allowance and all the money I earned were not worth one cup of coffee. You could go to the baker in the morning and buy two rolls for 20 marks; but go there in the afternoon and the same two rolls were 25 marks. … It had somehow to do with the dollar, somehow to do with the stock exchange—and somehow, maybe, to do with the Jews."

Bit by bit, the star of Hitler began to outshine the medals of Ludendorff. Economic salvation had become for most people the most pressing need. They were being turned from politics by the cost of living and low salaries. Hitler alone was capable of trimming his ship to every wind. The middle class was going Nazi.

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"Inflation is like a drug in more ways than one," remarked Lord D'Abernon. "It is fatal in the end, but it gets its votaries over many difficult moments." Hopelessly addicted, the Reichsbank ploughed on. By 1923, massive unemployment had come and inflation was pursued more rigorously than ever. Petty crime, the crime of desperation, was flourishing. Metal plaques on monuments had to be removed for safekeeping. Lead was beginning to disappear overnight from roofs, and petrol was siphoned from the tanks of motor cars. A cinema seat cost a lump of coal. With a bottle of paraffin, one might buy a shirt; with that shirt, the potatoes needed by one's family.

There were also stories of shoppers who found that thieves had stolen the suitcases in which they carried their money, leaving the money behind; and of life supported by selling every day a single link from a gold crucifix chain. A 5,000-mark cup of coffee would cost 8,000 by the time it was drunk.

In July 1923, Germany was introduced to a new range of banknotes: 10, 20, and 50 million marks. The political crisis had come to a head. When a printers' strike broke out, crowds with wheelbarrows surrounded the Reichsbank calling for banknotes. All that could be said about the currency was that it was still current, nothing having replaced it: but there was no measure of value and hardly a medium of exchange. On Sept. 1, the Reichsbank issued a note with a face value of 500 million marks.

The pervading uncertainty that had smothered the old national spirit was now the food of extremism. The most moderate persons declared that firmness—a strong hand—was required. Thus on Sept. 2, 1923, 100,000 demonstrators gathered for the Nazi rally at Nuremburg. Within the week, speaking five or six times a day, Hitler was calling for national dictatorship.

By the end of September, the government's control of the political, let alone the financial, situation was strained to the breaking point. So were the ministers: according to the Czech foreign minister they were so exhausted that they were incapable of real consideration of the problems, "the decision of which depends on which minister had the most sleep the night before." The proclamation of Sept. 19 threatening a month in jail and unlimited fines to anyone who hoarded food or money, or prevented the paying of taxes, or impeded the distribution of food was a useless act of desperation: everyone, ministers included, was hoarding everything; no one made any effort to pay taxes; and the only impediment to the distribution of food was the lack of currency to pay for it.

On Sept. 26, Chancellor Stresemann suspended seven articles of the Weimar constitution, declared a state of emergency, and gave executive powers to the defense minister. The country was divided into seven military districts, with a local military dictator over each.

Here, perhaps, was the strong hand that Germans wanted. There could now be restrictions on personal liberty. The army and police might interfere at will with postal, telegraph, and telephone services, indulge in house searches, and confiscate property. Incitement to disobedience could be punished with imprisonment or a fine of up to 15,000 gold marks. If lives were endangered, the punishment could be penal servitude.

Inflation is the ally of political extremists, the antithesis of order. At other times—in post-revolutionary Russia, in Kadar's Hungary—it may have been engendered to destroy the social order, for chaos is the stuff of revolution. In Germany at this time, however, the inflationary policy was the consequence of financial ignorance, of industrial greed, and, to some extent, of political cowardice. Hitler set his hopes in 1923 on "the revolt of starving billionaires."

When Schacht was appointed commissioner for national currency on Nov. 13, he faced incredible disorder. During the previous ten days, expenditure had exceeded revenue by 1,000 times. The floating debt had increased 15 times. The budgetary estimates included on every page the outrageous reminder that all figures were in quadrillions.

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The immediate basis of stabilization was not the closing down of the printing presses so much as the rigorous disciplining of state expenditure by the refusal of further credit to the government and by a return from a floating mark to a fixed parity against gold and the dollar. The government, having put the screws to the nation and made Schacht president of the Reichsbank for life, could do little but hope the cure would work.

Food began to appear again in the towns halfway through December. On Christmas Day 1923, Lord D'Abernon wrote of the "magical wand of currency stability." Sanity had returned to Germany's finances, and no doubt 1924, a period of extreme monetary stringency, consolidated the financial recovery. But it was too much to hope that years of reckless profligacy could be so easily paid for, or that what the country had passed through would have no lasting effects on the people's mind. The economic reckoning was still to come. "After a long devaluation," Schacht held on Jan. 24, 1924, "stability can only be regained at the cost of a severe crisis."

Germany's trouble was that the inflation boom had never been liquidated. The country that had undergone every conceivable form of collapse during the previous six years now crashed downwards just as she was beginning to rise from her knees. Confidence was shattered. The flow of foreign money slackened. The Reichsbank policy of credit restriction was maintained as firmly as ever to counteract a net outflow of gold and foreign exchange. There was such an alarming rise in the cost of living that to prevent agitation the index had to be cooked. Much though public works were instituted to try to mop up labor, the unemployed figure passed 1,300,000 by December 1925, presenting the politicians' nightmare of 1922: unhidden mass unemployment that the policy of inflation had so largely been designed to avoid.

The scourge of inflation, it must be emphasized, followed the scourge of defeat in war, so that one must hesitate to affirm that the psychological trauma of the early 1920s would have been absent but for the insecurity that endless depreciation of the currency brought. National disintegration and social upheavals unconnected with the money supply, after all, are enough to promote ethical degeneration and contempt for old standards of behavior in any community. It remains the case that those who lived with or observed the process attributed what they saw first and foremost to inflation: fear, greed, immorality, demoralization, dishonor.

As the old virtues of thrift, honesty, and hard work lost their appeal, everybody was out to get rich quickly, especially as speculation could yield far greater rewards than labor. While the anonymous, mindless Reichsbank was prepared to be the dupe of borrowers, no merchant would have wished to let the opportunities for enrichment slip by while others were making hay. For the less astute, it was incentive enough, and arguably morally defensible, to take every advantage of the unworkable fiscal system merely to maintain financial and social position.

As that position slid away, patriotism, social obligations, and morals slid with it. The air of corruption was general. Democracy may have survived inflation, but there was little evidence of universal gratitude for that deliverance. Monarchism was the more popular creed, and it may be that the exposure of Germany's moral wounds—the financial scandals of the inflationary years—contributed greatly to the strengthening of the disciplinarian side of the nation's character.

Where did the story end? More than any other thread that links the two world wars, the history of the inflation is a reminder that the second was an extension of the first. Inflation for Germany was an unwitting part of the process of stoking the emotional boilers for a resumption of hostilities when the power to wage war returned. Not only did the loss of former affluence and the destruction of the old moral ethic humiliate the human pillars of society: in German minds democracy and republicanism had become so associated with financial, social, and political disorder as to render any alternatives preferable when disorder threatened again.

With inflation alone, noted Günter Schmölders, can a government extinguish debt without repayment or wage war and engage in other nonproductive activities on a large scale: it is not recognized as a tax. Thus did Hitler resume deficit spending to finance armaments in 1938, and the experience begin again.

To say that inflation caused Hitler, or that inflation elsewhere could produce other dictatorships, is to wander into quagmires of irrelevant analogy. Comparable, coincidental circumstances in Austria and Hungary do not support such a notion. On the other hand, the vast unemployment of the early 1930s gave Hitler the votes he needed, and it is indisputable that in the inflationary years, Hitler first tried his fingers for size on the throat of German democracy. Inflation did not conjure up Hitler, but it made Hitler possible.

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Money is no more than a medium of exchange. Only when it has a value acknowledged by more than one person can it be used. Once no one acknowledged it, the Germans learnt, their paper had no value. The discovery that shattered their society was that the traditional repository of purchasing power had disappeared and that there was no means left of measuring the worth of anything. For most, degree of necessity became the sole criterion of value, the basis of everything. Man's values became animal values.

When life is secure, society acknowledges the value of luxuries, those enjoyments without which life can proceed but which make it much pleasanter. When life is insecure, values change. Without warmth, a roof, or adequate clothes, it may be difficult to sustain life for more than a few weeks. Without food, life can be shorter still. At the top of the scale, the most valuable commodities are water and air. For the destitute in Germany, whose money had no exchange value, existence came very near these metaphysical conceptions. It had been so in the war. In *All Quiet on the Western Front*, Müller died "and bequeathed me his boots—the same that he once inherited from Kemmerick. I wear them, for they fit me quite well. After me, Tjaden will get them: I have promised them to him."

In war, boots; in flight, a place in a boat may be the most vital thing in the world, more desirable than untold millions. In hyperinflation, a kilo of potatoes was worth more than the family silver. A prostitute in the family was better than an infant corpse; theft was preferable to starvation; warmth was finer than honor; clothing more essential than democracy; food more needed than freedom. ■

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Deflated Expectations

When fear of falling prices becomes a self-fulfilling prophecy

By George Selgin

LET'S BEGIN WITH A LITTLE word association. Here goes: "deflation." Let's see: default, panic, crisis, credit crunch, layoffs, foreclosures, unemployment, recession, depression … Great Depression.

Now there was a deflation. Between the October 1929 stock market crash and FDR's inauguration in March 1933, the general price level fell 25 percent, while wholesale prices fell a whopping 37 percent. As prices dropped, so did employment: by the time prices reached bottom around March 1933, a quarter of the U.S. labor force was out of work. Nor did falling prices help the economy to right itself. Instead, the deflation only seemed to make things worse, in part by increasing the burden of debt. The lower prices went, the more the real value of every dollar owed went up. Defaults piled up, causing more banks to fail, making credit even scarcer, which meant that there was even less money around, so prices had to fall further. Economists call this a debt-deflation spiral, and they agree that it's the last thing an economy needs.

Not surprisingly, the U.S. emerged from the trauma of the Great Depression with a severe case of deflation anxiety that still has us in its grip. Fear of falling prices is so great that the inflation rate has only to dip below 2 percent—a rate at which prices would still double in 36 years—to get pundits chanting about economic collapse and the Fed's Board of Governors stoking money into the economy like their lives depended on it.

Needless to say, if the inflation rate ever manages, despite the Fed's efforts, to fall below zero, utter panic takes hold. So when the Bureau of Labor Statistics reported negative monthly inflation three times in a row starting last October, the press went to town with reports of gloom and doom, and the Federal Reserve Board took the unprecedented step of giving money away by lowering the federal funds rate—the overnight rate for inter-bank loans—all the way to zero. Who can blame it? After all, the circumstances surrounding the recent deflation bear an eerie resemblance to those surrounding the downward plunge of the early 1930s, with falling prices going hand-in-hand with declining sales and rising unemployment and loan defaults. These events are precisely the things that can fuel a downward economic spiral—which the Fed is supposed to prevent.

And yet, for all the harm it has done, and might still do, deflation gets a bad rap. Although the Fed and other central banks don't seem to realize it, deflation isn't always as dangerous as it was in the 1930s. There's another kind of deflation that can actually be a good thing. And when central banks stand in the way of this good sort of deflation, the results can be disastrous. The current bust is a case in point.

We'll come back to that. But first, some more word association. The word this time is "innovation." How about research and development, new technology, efficiency gains, cost-cutting, price-cutting … deflation.

Yes, deflation again. But this isn't the bad deflation of the 1930s. It comes not from consumers having less money to spend but from them being confronted with more to spend it on. "Bad" deflation happens when demand shrinks; "good" deflation happens when supply expands.

The difference between the two sorts of deflation couldn't be more basic. Most people grasp it without a hitch. Unfortunately, economists seem to be the exception, perhaps because of their obsession with the Great Depression and zeal to avoid repeating it. Nor has their understanding been aided by the fact that none of them has ever actually witnessed the good sort of deflation.

Yet good deflation isn't just hypothetical. For much of the 19th century, when the gold standard prevented central banks from printing money willy-nilly, prices fell more often than they rose, and people considered that tendency to be perfectly natural. After all, technology was improving, so goods cost less to produce. Why shouldn't prices reflect that reality? From 1873-96, for instance, prices in most gold-standard countries fell at an average rate of about 2 percent a year, while real output grew at correspondingly healthy rates of between 2 and 3 percent, thanks largely to productivity gains. That isn't to say that there weren't occasional crises—there were, and some involved a dose of bad deflation, driven by temporary lulls in lending and spending. But the general trend of spending was up, while the downward trend of prices remained within