COMPARING CURRENCIES IN DECLINE

German Inflation in the 1920s from an East-Central European Perspective

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ABSTRACT: This paper argues German inflation should be studied within a broader East-Central European perspective as European post-war hyperinflation was a fate the German Republic shared with Austria, Poland, Hungary, and Russia, whereas monetary developments in Western Europe were very different. This paper takes a comparative approach to the question of what in-sights can be gained from this perspective. In situating German inflation in relation to East-Central European developments in the 1920s, the paper first of all considers contemporary comparisons that Germans made in the early 1920s with East-Central European currencies, the Polish mark in particular. It argues that such downward comparisons supported a puzzling, long-prevailing optimism of Germans regarding the fate of their own currency. Second of all, the paper employs insights from historical research on inflation in East-Central Europe to place existing narratives of German inflation into a larger European perspective. From the perspective of East-Central European inflation experiences, the fundamental importance of capital shortages, violence, and state fragility are emphasized as relevant for explaining German inflation.

Keywords: Inflation, foreign currencies, economic entanglement, comparison, state capacity
JEL Codes: N14, N24, N44, N94, 016

1. Introduction

German inflation of the 1920s has been studied in detail, but it has also been studied from a heavily Western-oriented perspective. In Gerald Feldman´s seminal study, France, the United States (US) and Great Britain take center stage. The Netherlands and Austria are occasionally mentioned. Poland, the Czechoslovak Republic and Hungary are mostly ignored.[1] General (economic) histories of interwar Europe have long taken a more balanced perspective of European developments, highlighting parallel developments and connections.[2] From an economic history perspective, the Great Depression in Germany has been discussed in relation to other European experiences rather than as an exceptional national phenomenon.[3] This paper argues German inflation should also be studied within such a broader European perspective, and that an East-Central European perspective is of particular relevancy. Post-war hyperinflation was a fate the German Republic shared with Austria, Poland, Hungary, and Russia, whereas monetary developments in Western Europe were

1 Feldman (1997). Also see Holtfrerich (1980); Webb (1989); Ferguson (1995).
2 E.g. Barth (2016); Aldcroft (2006); Ritschl/Straumann (2010).
3 Straumann (2009). Köster (2020) discusses the Great Depression in direct relation to inflation as a Europen-wide phenomenon of the interwar period.

very different *(see Figure 1)*. As Figure 1 suggests, East-Central Europe constituted a space of economic entanglement in which the inflationary dynamics of the early 1920s unfolded. The area was also a region that German contemporaries focused more on than the Western-centric view of economic historians suggests. Germans in the early 1920s frequently drew comparisons between the mark and foreign currencies; until late into 1922, they did not consider their own mark as exceptionally inflationary within the European context, whereas they did for the currencies of Poland, Austria and Hungary. The need to understand German inflation in a larger East-Central European perspective seems obvious given the connections and parallel developments.[4]

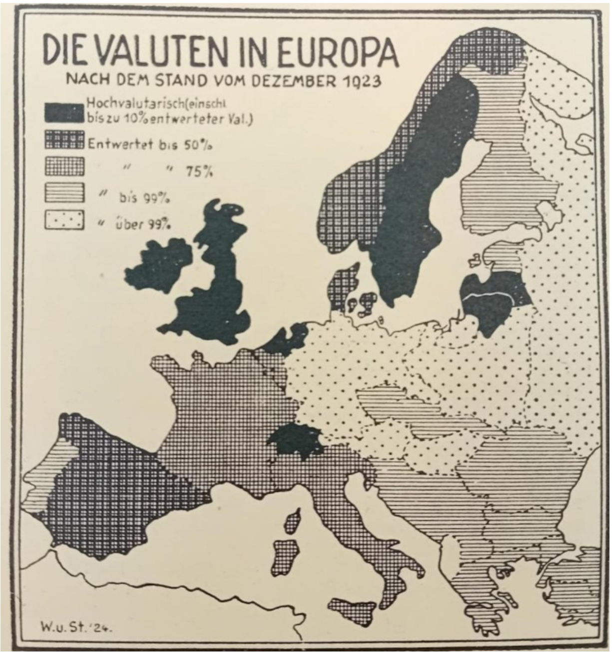

Figure 1: Foreign Currencies in Europe in 1923
Source: Wirtschaft und Statistik, 1924, H. 2, p. 59.

Research on German inflation is dominated by the seminal works of Holtfrerich, Feldman, Webb, Ferguson and Geyer, all published during the 1980s and 1990s.[5] More recent accounts provide surveys of German inflation, setting out their own

4 The term "East-Central European perspective" is meant here in a strictly spatial sense, referring to European countries to the East and South-East of Germany. It does not refer to any assumption of collective identity, regional specificity or contemporary German perceptions.

5 Holtfrerich (1980); Feldman (1997); Webb (1989); Ferguson (1995); Geyer (1998).

priorities and specific claims but without considering any extensive new source material.[6] This point also applies to the recent study by Harold James that situates German inflation within a long-term global context.[7] The 100-year jubilee literature of 1923 has partly engaged in historical interpretation of the Weimar Republic.[8] Regarding hyperinflation, however, no new explanations have been offered. If studies adopt an international perspective, that perspective is oriented toward the West. No historical account of German inflation has attempted to understand the topic within a larger East-Central European context.

If parallel movements existed in the decline of different currencies in East-Central Europe, what insights can be gained to help explain German inflation? Historians have tended to highlight the unique features of German inflation as a specific historical phenomenon, meaning comparative approaches have not been at the center of research. This approach is in contrast to historical inflation research on the former territories of the Habsburg Empire, which has often taken on a comparative dimension.[9] Economists, however, have long tried to exploit the simultaneity of inflation in the 1920s, including in Germany, to obtain general insights. For economists, the phenomenon of inflation can be identified and explained independently from specific historical contexts. Comparing parallel inflations of the 1920s, therefore, came at the cost of narrowing down the complexity of historical processes to one or two variables.[10] When searching for theoretical insights regarding inflation more generally, specificities of historical processes during the 1920s have been largely ignored. For many historians, such approaches suffer from a "radical isolation of the object of comparison from its historical context."[11]

This paper takes a different comparative approach to the question of what insights can be gained from a comparative perspective. In situating German inflation in relation to East-Central European developments in the 1920s, the approach utilizes two comparative perspectives on currency decline that have been underexplored for analyzing the topic. In the first part, the paper considers contemporary comparisons that Germans made in the early 1920s with East-Central European currencies, the Polish mark in particular. It argues that these downward comparisons can help to explain why German inflation expectations were remarkably optimistic as late as 1922. In the second part, the paper employs insights from historical research on inflation in East-Central Europe to place existing narratives of German inflation into a larger European perspective. The comparison of German and East-Central European inflations is not meant in the manner of isolating the most relevant factors; it acknowledges the historical insight that, like each postwar hyperinflation in East-Central Europe, German inflation had important and unique dimensions.

6 Taylor (2013); Teupe (2022).
7 James (2023).
8 Longerich (2022); Reuth (2023); Pohl (2022); Jones (2022); Ullrich (2023).
9 E.g. Faltus/Teichova (1996); Teichova (1997).
10 Teupe (2022), pp. 17–35.
11 Welskopp (2010), p. 7. The historical literature has highlighted the heterogeneity of inflationary processes in East Central Europe, contrasting the isolated economic models with a complex historical reality. Teichova (1988), pp. 118–119.

However, adopting a broader comparative view helps to substantiate some elements of the established narrative of German inflation while diminishing the explanatory power of others. From the perspective of East-Central European inflation experiences, the paper emphasizes the fundamental importance of capital shortages, violence, and state fragility as relevant for explaining German inflation.

2. Looking "East" –The "Valuta Question" beyond the Dollar

Researchers have had good reasons for focusing on the US, Great Britain, and France to understand German inflation rather than on Poland or Hungary. The Western nations won the First World War (WWI), by far the most important historical background for German inflation. The Western Allies decided on the terms of the peace treaties, greatly influencing national borders and economic capacity. Many of the resulting issues necessitated ongoing negotiations and arrangements, so that France, Great Britain, and the US remained heavily, if reluctantly, involved. From a German perspective, reparation payments were the most crucial point of political contention. For many contemporaries and historians alike, these payments seemed to explain much of the devaluation of the mark. In this regard, France certainly played a more important role than any other nation.

Economic power was also heavily tilted toward the West. Great Britain, the US, and France had been the countries with which an industrializing German Kaiserreich had competed and compared itself. Foreign trade with the West comprised a much higher share of total imports and exports than trade with the East. Economic power also meant financial power, and this was particularly true and important in the case of the US, which dominated world finance, particularly after 1918. For Europe as a whole, desperately short of capital, this aspect was an important focal point.

German contemporaries of the early 1920s were fully aware of Western economic dominance and its relevancy for their economic and political fate. However, in contrast to economic historians, Germans of this period were equally interested in developments in East-Central Europe, and they were well aware of the difficult monetary situation in Austria or Poland. The Valuta Question (i.e., the question of how much value the mark had in foreign markets) received widespread "public attention."[12] As a publication written at the height of hyperinflation argues, Valuta was "on everyone's lips", whether worker, small businessman, farmer or state official.[13] In the years following WWI, many Germans became preoccupied with exchange rates in order to assess Germany´s economic strength.

If Germans compared themselves with the US or Great Britain, the outlook looked grim. From the beginning of World War I, the German currency had kept devaluing against the dollar and pound. However, if Germans turned eastward, they could, for a long time, draw much more optimistic conclusions. This relativity of

12 Pohle (1920), p. 3.
13 Schult (1924), p. 43 (own translation).

the German currency may not have been commonplace, but it was a common thread in the German technical literature at the time. “If we compare the purchasing power of the German mark with that of the American dollar on two different days,” an introductory textbook explains,

> we find that on the later day, for example, the mark had a lower purchasing power than the dollar […] At the same time, however, the German mark may have risen against the Russian rouble or the Austrian crown. The fall or rise of the mark, measured against the money of other countries, is therefore very different.[14]

Charts of the German currency’s value in other countries display a diverging trend, dividing the picture into three groups of countries. Against one group that included Poland and Austria, the German mark appreciated; against another group to which the US and Great Britain belonged, it depreciated; and against the third group, including Czechoslovakia, it remained more-or-less on par. The relatively positive trend continued as long as German inflation levels remained below those of countries such as Austria, Hungary, or Poland. Against the Polish currency, the mark even followed a favorable development until 1923 (i.e., long after Germany had entered hyperinflation).

Figure 2: Chart of the German Mark’s Value Compared with Central and Eastern Europe, 1921
Source: Die Valuta, 5. November 1921.

14 Schult (1924), p. 45 (own translation).

German nationalists, such as Johannes Aderhold, could find some comfort in the comparison with Poland: "Our Germany […] will rise again to new development and prosperity. Thanks to the rediscovered will to work […], the future is secure for us again, despite all the difficulties of the present," he optimistically claimed in 1921. "The same cannot be said of our envious, rapacious rival Poland," Aderhold continued. "Poland's economic and financial situation presents a picture of the most boundless depression."[15] This statement was more than mere propaganda; it reflected a deep-seated nationalistic and racist sense of superiority. The Valuta Question was used to verify this worldview. As late as 1922, a contemporary publication distinguished three groups regarding the Valuta. The bottom group comprised the "verelendetsten" (most impoverished) countries of East-Central Europe (Russia, Poland, Austria, and Hungary). Germany was considered as belonging to the middle group, together with Czechoslovakia and the Balkan States.[16]

Another way the relatively worse development of the Polish currency made itself directly and visibly felt in Germany was through German migrants. On November 20, 1919, Polish officials decided to convert German into Polish marks at a statutory rate of 1:1. The German Ostmarkenverein lamented the following:

> Among the many acts of violence committed by the Poles and violations of the Treaty of Versailles, the currency law of November 20, 1919 […] is the most outrageous thing that has ever happened in the economic life of two peoples. With a difference in exchange rates of 1:4-5, it represents a policy of highway robbery that could not have been worse.[17]

According to a contemporary estimate, tens of thousands of Germans lost their savings due to the Polish currency laws. This event not only affected people from the lost territories but also German holders of Polish currency all over the country. The German Government even planned to compensate German refugees from the Ostmark, but eventually it considered such plans to be detrimental to the larger revisionist policy of maintaining a strong German presence in Poland.[18] The problem of creditor expropriation – today so tightly linked to the German narrative of inflation losers – was first discussed in terms of the Polish mark. Due to Polish inflation, a 1921 publication criticized that "a completely unjustified economic debt relief exclusively at the expense of the creditors, and to a large extent the German creditors"[19] was occurring. In historical perspective, German inflation has itself become

15 Aderhold (1921), p. 1 (own translation).

16 Braunthal (1922), p. 41.

17 Der Ostmarkenverein zu den deutsch polnischen Verhandlungen. GStA PK HA I Rep. 195 Anhang Nr. 25 Bl. 110; cited after Oldenburg (2002), p. 256.

18 German refugees from the East were granted some financial assistance in cases of particular hardship (§ 18 of the Verdrängungsschädengesetz vom 28. Juli 1921), but this did not amount too much. Haase (1921), p. 5-6.

19 Haase (1921), p. 18. Haase found "remarkable in this respect […] the increased drawing of the Posen mortgage bonds, in which the Posen region repaid the capital to an amount that at times did not even correspond to the sum of the annual interest at the level of the Polish currency" (own translation).

the epitome of expropriating savers.[20] By 1923 the German migrants would have lost their savings anyway. In contemporary comparative perspective with Poland, however, the already depreciating German currency was overlooked.

Such contemporary perceptions provide a key to understanding a particular puzzle of German inflation. This puzzle concerns the question of expectations. In economic theory, expectations have long been considered crucial for understanding inflation dynamics. If money-holders expect devaluation to continue, they will attempt to dispose of their money as soon as possible. Thus, inflation becomes a self-fulfilling prophecy. Examining how inflation unfolded over time in Germany, it is puzzling how long Germans and international investors believed in financial stability despite political turbulence and economic uncertainties. The point of a self-fulfilling prophecy was not reached before the summer of 1922, when Germany entered hyperinflation.[21]

Part of this belief was based on inflation having repeatedly stabilized for weeks or even months at a time. No one knew the future, and a mixture of reasonable optimism and wishful thinking could have been a relevant and not necessarily irrational factor in economic decision-making. The East-Central European perspective adds another possible explanation that highlights the relevancy of comparisons for assessing one´s own economic situation. The “Valuta Question” was an important way Germans made sense of their economic situation. Comparisons with the dollar and pound highlighted the difficult German economic situation, but there were other, more favorable comparisons with foreign currencies. If Germans were, in principle, optimistic regarding the fate of the mark, downward comparisons with the Austrian crown or Polish mark could well have supported such optimism.

3. German Inflation: Insights from East-Central Europe

In contrast to contemporary cross-country comparisons, historical research on inflation in interwar Europe has consisted of two strands with few connections. On the one hand, there are numerous accounts of German inflation. On the other hand, there is extensive historical research on inflation in East-Central Europe. Historical research in the English language is particularly extensive for the former Habsburg territories. There are also some noteworthy publications for East-Central Europe and Poland in particular, including the works by Wolf and Don-Siemion.[22] Significant parts of the research findings on East-Central European inflation were published in Polish or Czech language, and have remained largely detached from international discussion.[23] In contrast to the "national" histories of German inflation,

20 Regarding creditor expropriation, also consider the contribution by Thorsten Proettel in this volume.

21 Teupe (2022), pp. 137ff.

22 Wolf (2005), (2010); Wolf et al (2011); Don-Siemion (2021); von Thadden (1995). For an overview, also see Morawski (2017).

23 Landau/Tomaszewski (1967); Jaros (1969).

East-Central European perspectives take a much more entangled and comparative perspective. The cross-border economic ties of the former Habsburg territories are more obvious than Germany´s, and the currency question was a fundamental component in state-building, illustrated by the number of different currencies in Europe increasing from 10 before WWI to 27 afterwards.[24]

Inflation histories of East-Central Europe have rarely considered the developments in Germany, just as German inflation histories have tended to ignore developments in the East. From the perspective of the East, the "western states" look comparatively "stable",[25] which was certainly the case. What is questionable is whether postwar Germany should be grouped with countries such as France or Great Britain. While considering Germany a part of East-Central Europe would be misleading, many arguments for contrasting East-Central Europe with the West apply also to Germany. On a superficial level, some historical scholars have recently noted the similarity of hyper-inflationary dynamics, particularly striking in the cases of Poland and Germany. "The loose monetary policy of the Polish government," Gorny and Borodziej write, "most closely recalled the actions of neighboring Germany, which […] engaged in a mass printing of money without coverage."[26] Both Germany and Poland had to cope with the economic consequences of WWI: contested borders, a revolutionary government, and a civil administration ill-equipped to deal financially with the challenges it faced. Private loans, whether international or domestic, were neither possible in Germany nor in Poland. The two countries' "precarious political and economic condition"[27] prevented investors having the confidence necessary for such long-term investments.

The perception of Germany and East-Central Europe as two separate regions with distinct inflation histories has likely been substantiated by contemporary interpretations of the 1920s, followed by later developments of economic disintegration. For most Germans, the territorial losses following the Versailles treaty constituted a national trauma. The national categories in which many Germans came to think complicated a perception of economically integrated and comparable spaces. German economic historians of the interwar period have long accepted this perspective, calculating German material losses in terms of territory, resources and population rather than asking how the new borders altered the still-existent economic connections within these regions. The (still relevant) statistical conventions based on nationally defined territories supported this view.[28]

One important exception to the mutual neglect of German and East-Central European inflation histories is comparative econometric studies that have attempted to employ historical data to derive general insights. Such research has stemmed from the historically informed research on rational expectations by Thomas Sargent and

24 Baltzarek (2014), p. 97.
25 Morawski (2017), p. 1.
26 Górny/Borodziej (2021), p. 256. Also see Teupe (2022), pp. 87ff.
27 Landau (1975), p. 41.
28 For this argument in an (Eastern) European perspective, see Müller (2014), p. 10. For a narrative of disruption in the 1920s from a Polish perspective, see Kochanowicz (2014), p. 135.

others, published in the 1970s and 1980s. Focusing on Germany, Austria, Hungary and Poland, this research has attempted to highlight the importance of budget deficits and monetary policy regimes, with a focus on ending inflations.[29] Barry Eichengreen also considered these four countries as comparable cases for historical insight, arguing that a "war of attrition" was responsible for the postwar inflations.[30] More recently, Lopez and Mitchener have focused on the same set of countries to interpret the beginning of hyperinflation as the result of "uncertainty shocks".[31]

Does an East-Central European perspective on German inflation change the established historical narratives? To answer this question, it is necessary to first sketch out some important elements of these narratives. Although the historical process of monetary decline and its caesuras are uncontroversial and fully documented, historians have long disagreed on the most accurate explanation. Numerous inflation theories and causal factors have been offered and contested, as well as having been weighed very differently within the complex interplay of economic structures and political decisions in the early 1920s. The debate was intensified by the "lessons" that an interpretation of the event could provide regarding monetary theory or the general economic effects of inflation.[32]

The causal factors that could be isolated include, most prominently, the printing press in connection with monetary policy, public deficit and reparation payments, public debt, wage demands, foreign trade deficit, international capital flows, trust in the currency, uncertainty and expectations. Few historians would try to assign one of these factors some form of exclusiveness; German inflation – as probably any inflation – was a unique historical event that unfolded in time. Within that process, each factor played a role. Historians have disagreed, however, not only regarding their weighing of the different factors but also in their interpretation of historical agency and responsibility.[33]

Ferguson criticizes the German Government for excessive spending, whereas Feldman highlights failed attempts by politicians from the center and left to generate public funds when faced with resistance from big business and the far right.[34] Webb explicitly rejects the claim of excessive spending and considers international capital flows and their effects on inflationary expectations as the most central factor to consider.[35] Holtfrerich not only highlights the economic advantages of inflation before it became hyper but also situates the event within the larger international context of economic turbulence and a troubled German balance of payment.[36] Some

29 Sargent/Wallace (1973); Sargent (1982).
30 Eichengreen (1995), pp. 100ff.
31 Lopez/Mitchener (2018). Focusing on the Polish case, Don-Siemion argues that "the expectations of holders of Polish currency were rational rather than adaptive, and responded in particular to shocks to the expected future path of the military budget, the largest item in Polish state expenditure." Don-Siemion (2021), p. 91.
32 For an overview, see Teupe 2022, pp. 17ff.
33 See Ferguson (1996) and Schneider (1986).
34 Ferguson (1995); Feldman (1997).
35 Webb (1989).
36 Holtfrerich (1980).

have painted a picture of government weaknesses and political disorder, whereas others have blamed wage demands or stressed the importance of reparations.[37] Recently, Jones placed much of the blame on the Allies' malevolence, an argument that many Germans have supported since the infamous treaty of Versailles took effect.[38] A comprehensive literature review would go well beyond the scope of this paper, but the preceding summary should suffice to underline the level of disagreement in historical interpretation.

In German historiography, German inflation will remain a unique event – not only for the specific way the inflation unfolded, but also because it was linked to the fateful events that followed, most important of which was National Socialist rule. From a monetary perspective, German hyperinflation was far from unique, and it had an astonishingly close proximity in terms of space and time to the hyperinflations of Austria, Hungary and Poland. Not all causal factors of hyperinflation in these countries can be considered here. Historical research on East-Central Europe is as divided on the exact causes of hyperinflation and the weighing of different factors as it is regarding the case in Germany.[39] There are, however, three central aspects that traverse much of the historical literature on East-Central Europe: violence, state fragility and capital shortages. In comparative perspective a close relationship with German inflation becomes obvious.

3.1. Violence

One central aspect that distinguishes East-Central European perspectives of the early 1920s from that of Western Europe is the pervasiveness of armed force. For Western Europe, the armistice of November 11, 1918, marked the end of military conflict, but in the East, fighting continued.[40] Moreover, in the West, trench warfare had caused great destruction, but compared with the more dynamic development in the East, the regional scope of devastation was limited. The new nations that emerged from the collapse of the German, Habsburg and Russian empires not only faced creating a new civil administration, currency, tax and legal system from scratch, but also they had to build all of this on wrecked infrastructure and amid ongoing border disputes. This situation greatly determined the scope of political agency, as well as the setting of priorities. Regarding Poland, Don-Siemion concludes the following:

> The main reason for Poland's delayed monetary stabilization after World War I was not indecision by successive governments over the incidence of reforms, but the initially weak state

37 Siklos (1995).
38 Jones (2022).
39 For a research summary with regards to Poland, see Don-Siemion (2021), pp. 78ff. For the former Habsburg territories, see Teichova (1997).
40 Böhler (2014).