

The German Hyperinflation

In Figure 3.6 we omit inflation in Germany for the years 1922/1933. This note explains why.

With the outbreak of the First World War Germany went off the gold standard and financed the war by printing large quantities of money. As long as many goods were rationed and many of the men were away at the front, the rapid increase in the money supply was not immediately reflected in the inflation rate. However, in the years following the War inflation increased steadily, reaching 25% in 1921, while the harsh reparation payments imposed on Germany led the mark to depreciate by 96% against the dollar.

In order to buy the foreign currency demanded by the Reparations Commission, Germany began to buy foreign currency with marks at any price and the country moved towards hyperinflation. By December 1922 the mark had fallen against the dollar by a further 97%, while inflation rose to 3,400%.

Any hope of checking the collapse of the currency disappeared in January 1923 when French and Belgian troops occupied the Ruhr to ensure that reparations were paid in goods. Billions of marks were printed to finance these heavy new costs. By the end of the year the mark was effectively valueless at 4.2 trillion marks to 1 U.S. dollar, and inflation had risen to more than 200 billion percent. The effect on the real economy was severe. Businesses were disrupted and unemployment soared. The tax system virtually broke down, since tax receipts were almost valueless. By October 1923, 99% of government income came from the creation of new money.

Then in November 1923 the government replaced the worthless Reichsbank marks with a new currency, the Rentenmark that was linked to gold. Twelve zeros were cut from prices, and inflation in 1924 dropped to just 4%.

There are plenty of stories about life under hyperinflation. Here are a few

- During 1923 three hundred paper mills were working flat out printing banknotes. On October 25, 1923, the Reichsbank noted that it had that day printed 120,000 trillion marks. Unfortunately, the day's demand had been for one million trillion. However, the

bank announced that it was expanding production and the daily issue would soon be 500,000 trillion!

- The highest denomination note in 1923 was 100,000,000,000,000 marks, but few bothered to collect the change when they spent it.
- A factory worker described payday: "At 11:00 in the morning a siren sounded, and everybody gathered in the factory forecourt, where a five-ton lorry was drawn up loaded brimful with paper money. The chief cashier and his assistants climbed up on top. They read out names and just threw out bundles of notes. As soon as you had caught one you made a dash for the nearest shop and bought just anything that was going." Teachers, paid at 10:00 a.m., brought their money to the playground, where relatives took the bundles and hurried off with them.¹
- A student at Freiburg University ordered a cup of coffee at a cafe. The price on the menu was 5,000 Marks. He had two cups. When the bill came, it was for 14,000 Marks. "If you want to save money," he was told, "and you want two cups of coffee, you should order them both at the same time."
- A German housewife burned marks in her kitchen stove since this was less expensive than using the marks to buy firewood.

¹ This and the following story are cited in *Paper Money* by "Adam Smith," (George J.W. Goodman), Summit Books, 1981, pp. 57-62.