



the London School of **Economics**
and **Political Science**

Does Germany Owe Greece A Debt?

The European Debt Crisis in Historical Perspective

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Albrecht Ritschl

Motivation: Germans lazy, not the Greek

Data for 2010	Germany	Greece	France
GDP per Capita (US=100)	80	61	73
GDP per Hour (US=100)	91	57	98
Hours per Year	698	846	592

Source: OECD



Outline of talk

Two lines of continuity:

- Postwar Germany as a surplus country
- Long-standing monetary problems in Southern Europe



US policy towards Germany post-WW2

- European economic cooperation
- Debt forgiveness
- Export-led growth



Implementation of US Policy

- Marshall Plan conditionality: block other countries' claims on Germany
- EPU of 1950 as new, guaranteed framework for trade and payments.
- London Debt Agreement of 1953 blocking WW2 debts until reunification



German WW2 Clearing System

Trade Bilateralism since 1930s

Included 33 countries at the max

Limited multilateral clearing since 1940

Occupied countries with big surpluses towards Germany



Clearing Debt

Cumulative, end of 1944: 29 bn RM
of which later EEC countries: 21 bn RM
(Ritschl, EHR 2002)

at more realistic prices 86-90 bn RM
of which later EEC countries: 63 bn RM
(Buchheim, VfZ 1986)



The Greek case (occupation cost)

- Official data: 57.6 mill. RM

Internal memorandum (Buchheim, VfZ 1986):

- Corrected data: 500 mill. RM
[IfZ MF 260,7/29-3/24]

Total WW2 debt: How much is that today?

1. Relative to German 1938 GDP: 90%
(German GDP 2011 ~ 2.6 trn €)
2. At 4% compound interest: 612bn €
3. Try your own ... 😊

German War Debt to Greece

Relative to German 1938 GDP: 0.5%

At 4% compound interest: 3.4 bn €

→ OK, but this does not even begin to pay for Greece's current debts



A Counterfactual

What if post-WW2 Germany had been burdened with foreign debt equal to 90% of its 1938 GDP?

It was not.



Problems of US policy

Unwillingness of Europeans to trade with postwar Germany

- German resources idle while urgent reconstruction needs in WE
- Devise new payments system that deals with and guarantees payments from Germany

European Payments Union 1950

- Multilateral clearing including Germany
- Underwritten by US up to deficit cap
- Sanctioning mechanism to guarantee cap
- Tariff reduction



EPU crisis 1951

- Germany exhausts cap
- WE trade partners suspect Germans intend to default
- BdL (=pre-Bundesbank) mulls default
- German government exerts pressure to keep interest rates low

Solving German EPU crisis

- OEEC sends in two experts, threatens sanctions
- US military gov't makes a few phone calls

→ Gov't humiliated, forced to cut budget

→ Central bank independence now sacrosanct



The Double Marshall Plan

- Outer Marshall Plan = ERP+conditionality
- Inner Marshall Plan:
 - Self-sustained European reconstruction
 - Centered around W German export-oriented growth

→ Requires credible German institutions

→ Requires French leadership



Marshall Planners on the Learning Curve

- Draw the right conclusions from WW1
- Avoid recycling German debts



Lessons from WW1

- Inconclusive end to hostilities
- Attempts to remote-control Germany through economic levers

→ **Limited enforcement**



Two views on sovereign debt

- Capacity to pay (Keynes, 1919)
- Willingness to pay (Mantoux, 1946)
- Modern sovereign debt literature
 - IR and IC constraints (Eaton/G'vitz/Stiglitz 1986)
 - Renegotiation proof debt limits (Bulow/Rogoff 1989)

Capacity vs Willingness to Pay

- Moral hazard problem in Dawes Plan
 - Protect private creditors from reparations transfers
 - Political debt now junior to private debt
- ➔ Incentive to issue commercial debt to drive out political debt

Commercial and Reparations Debts

Foreign Debts and GDP -- million reichsmarks --

	Gross Debt		GDP	Foreign Debt/
	Commercial	Reparations		GDP
1930	32.6	35	82.9	81.5
1931 (mid-year)	33.6	35	<i>68.5</i>	100.1
1932	25.9	--	56.4	45.9

Notes: Figures in italics are quarterly, annualized
Sources: Bundesbank (1976), Ritschl (2002).



German Debt Default 1933

- Freeze transfers on all debt except
 - Trade debt to UK
 - Bilateral clearing debt
- Initially, service about 50%, quickly reduced to trivial amounts



London Debt Agreement 1953 (Hermann Josef Abs, Deutsche Bank)

- Revive ca 16 bn RM/DM of debt
- Repay at v low interest rate
- Postpone WW2 debts and reparations to unification
- Agree to individual compensation packages



W Germany's Status, early 1950s

- Debt / income ratio: 20 %
- Capital mobility: limited until 1956
- Current account: positive since 1951
- Inflation: < 2 %
- Unemployment: 8-10%
- TFP growth: > 10%



Fast Forward: German Net Foreign Assets Today

- 1974: 17 % of GDP
- 2005: 20 % of GDP
- 2010: 40 % of GDP and rising fast



Fast Rewind: Southern Europe under the Gold Standard

- Predated by Latin Currency Union
- Became universal after 1876 adoption of GS by Germany

→ de-monetization of silver



Hopping off the bandwagon: exits from the Gold Standard pre-1914

Latin America:

Argentina

Brazil

Chile

Europe:

Portugal

Spain

Italy

Greece

→ Lessons, anyone?



Not touched by Midas:

Italy: managed to shadow GS

Greece:

- 3 debt defaults in 19th century
- 1893- : international financial controls
- 1932: 4th debt default
- 2012: ... ?



Lessons from & for history

Abuse of clearing mechanism:

- WW2: Germany appropriating funds
- Target2: Germany releasing funds



Lessons from & for history

Unpleasant monetarist arithmetic:

To prevent debt default or inflation

-> micro-manage debtor's fiscal policy

-> micro-manage interest rates

- 1928-32: Bérenger/Poincaré/Mellon
- 2010-12?: Schaeuble



Lessons from & for history

- 2-sided principal-agent problem of debtor's government
 - 1929-32: technocratic gov't (Bruening)
 - 2011-12: technocratic gov't (P-demos, Monti)
- Lacking democratic legitimacy
 - Young Plan referendum 1930
 - Papadopoulos referendum 2011
- Debt default and domestic political turmoil
 - Elections and demise of Weimar Republic 1932/3
 - Greece, May 2012?

