

## **What Caused Hyperinflation In Germany and What Effects Did It Have On The Ordinary People?**

30/04/2007

The inflation problem actually began at the beginning of World War I. It was then that the German Government started to accumulate debt and to increase the money supply. Because they thought they would win the war and intended to force the losers to pay for all costs, they chose to finance the war through borrowing, rather than through taxes. Furthermore, as soon as the war broke out, the central bank (Reichsbank) declared its currency notes no longer redeemable for gold. This prevented a run on its gold reserves and allowed it to concentrate on helping the central government finance the war. However, by suspending the redeemability of its notes, the Reichsbank was no longer restricted in the amount of money it could print. With this restriction lifted, the German Government ordered the Reichsbank to print more and more money to finance the ever-increasing war expenditures. As the Reichsbank printed more money, the value of money already in circulation decreased, and people lost purchasing power as they indirectly financed their government's debt.

By the end of the war, the amount of currency in circulation had increased 400%. Although one might expect the price levels to have increased by about the same amount, it was actually only about 140% higher than it was at the beginning of the war. This was due to the fact that, at first, people thought price increases were due to shortages and were waiting for prices to fall to make purchases. However, as soon as they realized the rise in prices was due not only to goods being less available, but also to inflation of the money supply, they began to spend at faster and faster rates.

In any economy, once people realize that price levels are rising, a vicious cycle begins. People will start to ask for higher wages, anticipating higher price levels in the future. These expectations must necessarily turn into reality, since higher wages mean higher costs of production, which mean higher prices. It is for exactly this reason that hyperinflation causes the damage that it does. As I said above, the German Government controlled the Reichsbank and therefore they are completely responsible for the economic devastation of hyperinflation.

Admittedly, the reparation payments (the yearly sums, Germany had to pay to the Allies under the Treaty of Versailles) were burdensome but did the German Government necessarily have to print more money to finance them?—No! An alternative solution would be for the Government to sit back, and allow the natural economic forces to play out. After several years, the economy would eventually stabilize. At least this way, hyperinflation would have been avoided, and so many people would not have lost their life savings.

Which is better unemployment and no inflation or full-employment and hyperinflation? Neither are good options. I am not claiming that other economic policies could have made Germany better off. In fact, we will never

know what policy would have brought about the best possible welfare of the German people at that time. All I am saying is that the German Government did have other options and just printing more money may not have been the best solution.

The hyperinflation finally ended in November 1923 when the German Government decided to give up in its struggle for the Ruhr and stabilize the currency. (French and Belgian troops had occupied the industrial area of the Ruhr on the basis that Germany was not keeping up with the reparation payments. When the workers there went on strike, the German government supported them, printing even more money to pay them. At this point the hyperinflation was at its worst.) On October 15 the Rentenbank Decree was published, and on November 15 the mark was officially stabilized at the rate of 1,000,000,000,000 paper marks for 1 gold mark. People wanted so desperately to believe that their currency actually had value, that they did believe it. The central bank upheld its citizen's confidence by not allowing the government to borrow further.

Although the "miracle of the Rentenmark" had solved the problem of inflation, the devastating consequences of inflation could not be changed. Not only were millions of the German people much poorer, but also they were discouraged and depressed. After a lifetime of hard work, they had absolutely nothing to show for it. The bitterness of the population after losing the war and suffering through the period of hyperinflation would soon play into the hands of Hitler and aid him in his rise to power.

If the German Government had had put an end to its inflationary policies immediately after WWI, the German people would not have had to suffer through hyperinflation and would have avoided its consequences. Other economic difficulties (perhaps unemployment) would have presented themselves, but at least most people would not have lost their entire life savings. As I said before, it was not the German Government's fault for the extent of the inflation, but it does hold responsibility for starting it. At first the Reich printed money to finance its debt, but later it had to continue printing the money just to keep up with people's expectations. The story of German hyperinflation of the early 1920's teaches an important lesson about the nature of inflation. Once inflation starts, it is very hard to control! No one understood this lesson, better than the Germans themselves.

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