Does Germany Owe Greece A Debt?

Euro Symposium Bayreuth, 12 January 2012

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Preview of Results: One-line Summary

- Well, er, … No.
Two-line summary

- Gross debt: some (but not enforceable)

- Net debt: of course not
**Motivation, I:**

Germans lazy, not the Greek

<table>
<thead>
<tr>
<th></th>
<th>GDP/Head (US=100)</th>
<th>GDP/Hour</th>
<th>Hours/Yr</th>
</tr>
</thead>
<tbody>
<tr>
<td>2010</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Germany</td>
<td>80</td>
<td>91</td>
<td>698</td>
</tr>
<tr>
<td>Greece</td>
<td>61</td>
<td>57</td>
<td>846</td>
</tr>
<tr>
<td>France</td>
<td>73</td>
<td>98</td>
<td>592</td>
</tr>
<tr>
<td>OECD</td>
<td></td>
<td></td>
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</tr>
</tbody>
</table>
Motivation, II:

- Series of German Debt Crises in 20th c
- Solutions after WW2 reflect learning process from
- failed solutions after WW1
Motivation, III

- Post-WW2 European financial integration
  - Largely a direct response to this debt problem
  - Creates path dependency
  - With effects lasting till today
Motivation, IV

- Current response to Mediterr. crisis
  - resembles post-WW1 policies
  - carries substantial downside risks
  - has so far been self-defeating
Outline of talk

1. German WW2 clearing debts (& Greece)

2. Postwar debt forgiveness, 1948/53

3. German debt troubles post-WW1

4. Lessons from (and for) history
How Could Germany Owe Greece a Debt?

- Wartime Reichsbank Clearing System
- Used by Germany to Account for Extraction of Goods and Resources from Occupied and Neutral Countries
  - Not a complete account
  - Manipulated exchange rates
German WW2 Clearing System

Trade Bilateralism since 1930s

Included 33 countries at the max

Some 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)
Including “contributions”,
at more realistic prices 86-90 bn RM
of which later EEC countries: 63 bn RM
(Buchheim, VfZ 1986)
By country
The Greek case (occupation cost)

- Official data: 57.6 mill. RM

Internal memorandum (Buchheim, VfZ 1986):
- Hyperinflation in Greece, bad deflation methods used

- Corrected data: 500 mill. RM
  
  [IfZ MF 260, 7/29-3/24]
The total: How much is that today?

1. Relative to German 1938 GDP: 90%

2. At 4% compound interest: 612bn €

3. Try your own … 😊

4. Relative to post-WW1 reparations – ?
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.
US policy towards German WW2 debt

- All clearing accounts blocked
- Marshall Aid first charge on Germany
- 1953 London agreement: clearing debts and occupation costs to be settled after future German unification
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

- Interest rate is hiked up
- BdL imposes quotas at discount window
- Adenauer gov’t humiliated, forced to cut budget
- Fights rearguard battle against independence of future Bundesbank
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

Rivalling groups within US administration

- Treasury (Morgenthau): Punitive approach, complete post-WW1 job
- War, State Depts (Kennan et al.): Let US Army do its job, occupy the place for a generation, redevelop its economy, this pays for recovery
Lessons from WW1

- Inconclusive end to hostilities
- Attempts to remote-control developments 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)
## Reparations after WW1

<table>
<thead>
<tr>
<th>Reparations and German GNP (bn M/RM)</th>
<th>1913</th>
<th>1925</th>
<th>1929</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Nominal GNP (bn reichsmarks)</strong></td>
<td>51</td>
<td>71.1</td>
<td>88.4</td>
</tr>
<tr>
<td><strong>Reparations (bn gold marks / reichsmarks)</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(a) London ultimatum</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>A bonds (net indemnity)</td>
<td>12</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>A + B bonds (38 bn, for inter-allied war debt)</strong></td>
<td>50</td>
<td></td>
<td></td>
</tr>
<tr>
<td>A + B + C bonds (82 bn)</td>
<td>132</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(b) Dawes Plan of 1924 (NPV)</td>
<td></td>
<td>46</td>
<td></td>
</tr>
<tr>
<td>(c) Young Plan of 1929/30 (NPV)</td>
<td></td>
<td>37</td>
<td></td>
</tr>
</tbody>
</table>
Limited enforcement

1923: Invasion of Ruhr district by French, Belgian troops

1924: Dawes Plan
  - Rescheduling of reparations (de facto reduction)
  - Protection of transfers from commercial loans

1929/30: Young Plan
  - Reduction of reparations
  - End of transfer protection
Capacity vs Willingness to Pay

("..Numbers vs Incentives..")

- Moral hazard problem in Dawes Plan
  - Protect private from reparations transfers
  - Political debt now junior to private debt

→ Incentive to issue commercial debt to drive out political debt
## Capacity vs Willingness to Pay

### The German Balance of Payments

<table>
<thead>
<tr>
<th>Year</th>
<th>Exports (bn RM)</th>
<th>Reparations (net)</th>
<th>Interest (net)</th>
<th>Current Account (bn RM)</th>
<th>Long Term Credit (Net)</th>
<th>GDP (bn RM)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1925</td>
<td>14.4</td>
<td>-1.5</td>
<td>0.0</td>
<td>-5.2</td>
<td>1.6</td>
<td>0.7</td>
</tr>
<tr>
<td>1926</td>
<td>15.6</td>
<td>-1.6</td>
<td>-0.2</td>
<td>-1.0</td>
<td>1.9</td>
<td>74</td>
</tr>
<tr>
<td>1927</td>
<td>14.7</td>
<td>-1.9</td>
<td>-0.4</td>
<td>-6.0</td>
<td>2.1</td>
<td>83</td>
</tr>
<tr>
<td>1928</td>
<td>15.5</td>
<td>-2.2</td>
<td>-0.6</td>
<td>-4.5</td>
<td>1.9</td>
<td>89</td>
</tr>
<tr>
<td>1929</td>
<td>17.1</td>
<td>-2.6</td>
<td>-0.9</td>
<td>-3.9</td>
<td>0.5</td>
<td>89</td>
</tr>
<tr>
<td>1930</td>
<td>16.5</td>
<td>-2.1</td>
<td>-1.2</td>
<td>-1.6</td>
<td>1.0</td>
<td>1.8</td>
</tr>
<tr>
<td>1931</td>
<td>16.1</td>
<td>-1.4</td>
<td>-1.7</td>
<td>0.9</td>
<td>-0.1</td>
<td>69</td>
</tr>
<tr>
<td>1932</td>
<td>12.8</td>
<td>-0.3</td>
<td>-1.6</td>
<td>0.5</td>
<td>0.0</td>
<td>56</td>
</tr>
</tbody>
</table>
## Commercial and Reparations Debts

**Foreign Debts and GDP**  
--- million reichsmarks ---

<table>
<thead>
<tr>
<th>Year</th>
<th>Gross Debt</th>
<th>GDP</th>
<th>Foreign Debt/GDP</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Commercial</td>
<td>Reparations</td>
<td>GDP</td>
</tr>
<tr>
<td>1928</td>
<td>27</td>
<td>40</td>
<td>89.0</td>
</tr>
<tr>
<td>1929</td>
<td>31</td>
<td>40/35</td>
<td>89.2</td>
</tr>
<tr>
<td>1930</td>
<td>32.6</td>
<td>35</td>
<td>82.9</td>
</tr>
<tr>
<td>1931 (mid-year)</td>
<td>33.6</td>
<td>35</td>
<td>68.5</td>
</tr>
<tr>
<td>1931 (end)</td>
<td>26.6</td>
<td>35</td>
<td>58.1</td>
</tr>
<tr>
<td>1932</td>
<td>25.9</td>
<td>--</td>
<td>56.4</td>
</tr>
</tbody>
</table>

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

Abbildung III.7: Geld- und Kapitalmarktzinsen in Berlin

- PRIVATDISKONT
- TAGESGELD
- GOLDFPANDBRIEFE
OK, now back to the Golden Fetters

Eichengreen (1992):

- Interwar period a Mundell/Fleming world
  - GS a Fixed Exchange Rate System
    - Monetary policy ineffective
    - Fiscal policy effective
    - Role for Central Banks only if speculative attack

  ➔ Break-up of GS restores monetary policy effects
Golden Fetters (cont’d)

Eichengreen (1992) explaining why:

- Fiscal policy not chosen  
  (although should have been)

- CBs not performing LOLR functions  
  (although should have done so)
Breaking the Golden Fetters:
Unexplained Capital Movements

- Mundell/Fleming fails under high debt/income ratios
  - Peg to reserve currency starts lending spree, fresh debt made senior or given equal status
  - BOP sudden stops: money no longer endogenous
  - Funding crises: hard constraints on public deficits

<table>
<thead>
<tr>
<th>Year</th>
<th>Debt/GDP Britain</th>
<th>Debt/GDP Germany</th>
</tr>
</thead>
<tbody>
<tr>
<td>1913</td>
<td>33</td>
<td>67</td>
</tr>
<tr>
<td>1931</td>
<td>207</td>
<td>99+20</td>
</tr>
<tr>
<td>1938</td>
<td>171</td>
<td>61</td>
</tr>
</tbody>
</table>

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Lessons from & for history

(Lacking) private creditor involvement

- Dawes Plan: transfer protection
  → major moral hazard for debtor

- 2011-?: asymmetric haircut
Lessons from & for history

Debt moratoria not stopping recession

- Hoover moratorium 1931
  - Standstill on short term debt & reparations
  - GDP declines by a further 15%

- EU haircut proposal 2011
  - Has it stopped recession? Maybe.. Maybe not
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 : Bérenger/Poincaré/Mellon
- 2010-: 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
  - Papandreou referendum 2011

- Debt default and domestic political turmoil
  - Elections and demise of Weimar Republic 1932/3
  - ?