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Crack-up

“Everyone loves an early inflation. The effects at the beginning of inflation are all good. There is steepened money expansion, rising government spending, increased government budget deficits, booming stock markets, and spectacular general prosperity, all in the midst of temporarily stable prices. Everyone benefits, and no-one pays. That is the early part of the cycle. In the later inflation, on the other hand, the effects are all bad. The government may steadily increase the money inflation in order to stave off the latter effects, but the latter effects patiently wait. In the terminal inflation, there is faltering prosperity, tightness of money, falling stock markets, rising taxes, still larger government deficits, and still roaring money expansion, now accompanied by soaring prices and an ineffectiveness of all traditional remedies. Everyone pays and no-one benefits. That is the full cycle of every inflation.”

- Jens O. Parssons, ‘Dying of Money: Lessons of the Great German & American Inflations’.

“Is there any reason why the American people should be taxed to guarantee the debt of banks, any more than they should be taxed to guarantee the debts of other institutions, including the merchants, the industries, and the mills of the country ?”

- Senator Carter Glass during Senate debate on the Banking Act of 1933 (the Glass-Steagall Act).

“We contend that for a nation to try to tax itself into prosperity is like a man standing in a bucket and trying to lift himself up by the handle.”

- Winston Churchill.

Adam Fergusson begins his magisterial analysis of the Weimar collapse (‘When Money Dies..’) as follows:

“When a nation’s money is no longer a source of security, and when inflation has become the concern of an entire people, it is natural to turn for information and guidance to the history of other societies who have already undergone this most tragic and upsetting of human experiences.”

As Fergusson points out, studies of the period, of all kinds, tend to come with a common shortfall: they ignore the human element. Here, then, are some of the human stories recounted within his work.

In October 1923, the British Embassy in Berlin noted that the number of marks to the pound equalled the number of yards to the sun. Dr. Schacht, Germany's National Currency Commissioner, pointed out that at the end of World War I, one could in theory have bought 500,000,000,000 eggs for the same price as that for which, five years later, one could buy just a single egg.

In 1913, the German mark, the British shilling, the French franc and the Italian lira were all worth roughly the same. By the end of 1923, it would have been possible to exchange a shilling, a franc or a lira for up to 1,000,000,000,000 marks – but by then nobody was willing to take marks in return for anything.

Many, particularly at the time, assumed that the Weimar hyperinflation was a calculated German ruse to escape punitive reparations imposed by the Allies. Fergusson suggests something altogether different:

"The take-off point in the inflationary progress, after which the advent of hyperinflation was but a matter of time.. was not indeed to be found on the graph of the currency depreciation, or of the velocity of its circulation, or of the balance of payments deficit.. Rather it lay on the falling curve of political possibility, with which was closely linked the degree of political power and courage that the government, sorely pressed as it was, was able to muster.

"What really broke Germany was the constant taking of the soft political option in respect of money." [Emphasis ours.]

Then, as now, most economists missed the point, and very few could agree about the causes of the hyperinflation let alone propose workable solutions. In any event, the middle classes in Germany were wiped out gradually, and then in a huge, uncontrollable rush. Holders of German war loans, pensioners on fixed income, savers with money in the bank, all saw the value of their assets destroyed. Sensing the social tide, the Prime Minister of Bavaria submitted a Bill to the Reichsrat to make gluttony a penal offence punishable by imprisonment and / or fine (admittedly of a worthless currency).

As the value of the mark collapsed, the price of a loaf of bread in Berlin rose as follows:

Date	**Price (in marks)**
December 1918	0.5
December 1921	4
December 1922	163
January 1923	250
March 1923	463
June 1923	1,465
July 1923	3,465
August 1923	69,000

Date	Price
September 1923	1,512,000
October 1923	1,743,000,000
November 1923	201,000,000,000.

The young Ernest Hemingway, who crossed over from France during the period while working for the Toronto Daily Star, tells of converting the equivalent of 90 cents in Canadian money. He received 670 marks. He went to a fruit stand, selected five apples, paid with a 50-mark note, and received 38 marks back in change. A white-bearded elderly gentleman watched the transaction and approached Hemingway.

"Pardon me, sir," he said, rather timidly, in German, "how much were the apples ?"

"I counted the change and told him 12 marks.

"He smiled and shook his head. "I can't pay it. It is too much."

"He went up the street walking very much as white-bearded old gentleman of the old regime walk in all countries, but he had looked very longingly at the apples. I wish I had offered him some. Twelve marks, on that day, amounted to a little under 2 cents. The old man, whose life savings were probably, as most of the non-profiteer classes are, invested in German pre-war and war bonds, could not afford a 12 mark expenditure. He is the type of the people whose incomes do not increase with the falling purchasing value of the mark.."

Given historical distance and the passing of time, some Weimar anecdotes look almost quaint, but many are intensely moving, grotesque, or both. There are stories of shoppers who found that thieves had stolen the baskets and suitcases in which they carried their money – and had left the money itself behind on the ground. There are tales of restaurant meals which cost more when the bill arrived than when they were ordered. A 5,000-mark cup of coffee would cost 8,000-marks by the time it was drunk.

Looking back at the Weimar experience, there are some, at least partial, ways to protect against a superinflation. Short of owning a farm, the most obvious is physical gold. Other countermeasures include foreign exchange in sounder currencies (caveat emptor though: as the phrase has it, paper currencies don't float, they just sink against each other at different rates). Latterly, there is a case for ownership of productive assets.

And this is not to say that in the west we have reached the point of no return. Though the message from Professors Rogoff and Reinhart ('This Time is Different: Eight Centuries of Financial Folly') is hardly encouraging. R&R indicate that the tipping point for a country is when external debts surpass 73% of GDP, or 239% of exports. Beyond that level, the outcome is default or hyperinflation, or conceivably both. The US, by way of example, currently has external debts at 96% of GDP and almost 750% of exports, according to IMF data.

If we (a term that might in time include British, European, Japanese, even North American citizens) and our countries and our currencies do come to surpass the point of no return, however, it will not be as a result of those speculators now being excoriated by European politicians showing a damning and damnable inconsistency with their financial favours. It will be as a result of incumbent

politicians having singularly failed to show maturity, discipline and the most basic economic understanding in their stewardship (or debauching) of the national finances. Investment is always a probabilistic activity; right now, as investors, we have an abnormal duty to try and prepare for an extravagantly wide range of possible (if not probable) outcomes, and deflationary ice and / or inflationary fire are just the extremes of our potential range of climatic variables.

Here in the UK, a general election approaches. Ahead of that election, the broader electorate might wish to consider a useful mental image. Picture Gordon Brown and Alistair Darling (North American readers could use instead Alan Greenspan and Ben Bernanke) sitting at the roadside, having just been mugged. Some distance away, thieves are running off with empty suitcases flapping in the wind. As these luckless victims sit bedraggled in the gutter, nursing their wounds, they contemplate the pile of worthless currency lying in front of them.

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