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FINANCIAL VERGANGENHEITSBEWÄLTIGUNG:
THE 1953 LONDON DEBT AGREEMENT

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Financial Vergangenheitsbewältigung: The 1953 London Debt Agreement

Timothy W. Guinnane

Abstract

The 1953 London Debt Agreement settled Germany's debts from the period between the two world wars, and allowed the country to re-establish its role in international capital markets. The Agreement wrote-down the overall debt by about 50 percent and gave the debtors a much longer period to repay. One interesting clause in the Agreement allowed Germany to postpone some payments until such time as re-unification. The Agreement reflects a subtle and responsible understanding of the problems associated with the reparations and debt crises of the 1920s and 1930s, as well as fears about the moral hazard problems that would arise with making any part of the Agreement contingent on events Germany could influence. Recent advocates of third-world debt relief have held up the London Debt Agreement of 1953 as a precedent for debt relief for poor countries today. That argument reflects a misunderstanding of the historical circumstances of the early 1950s, as well as the economic principles reflected in the Agreement.

Keywords: Germany, London Debt Agreement, sovereign debt, debt overhang, HIPC initiative

JEL codes: N24, F34

People following the news when the two Germanies were reunited in October of 1990 paid most attention to the scenes of jubilant Germans celebrating the real end of World War II for their country. Two days after unification, the German Debt Administration announced that it would issue a new set of bonds. Those who read only the headline in a newspaper article might have thought, reasonably enough, that the new bonds were to pay for investments to upgrade the former East Germany's crumbling infrastructure, or to smooth the cost of bringing the former East Germans to the living standards enjoyed by those in the west. But these new bonds, in fact, were intended to repay debts that Germany had incurred as long ago as the 1920s.

A moment's thought suggests how puzzling this was. The Nazi regime had defaulted on all that debt.¹ Why would a new Germany want to pay off the debts repudiated by a brutal dictator? And why should Germany *start* repaying debts incurred so long ago? The simple answer is that these repayments were required under the 1953 London Debt Agreements. A better answer requires a return to some of the most traumatic events of the twentieth century. The story starts with the Versailles Treaty, which formally ended the First World War and at the same time (in the view of many) made a second war likely. It involves the terms that Treaty imposed on Germany, most notably the reparations the Germans did not think they could possibly pay. Successive governments, acting sometimes together and often at cross-purposes, tried to restart the German economy with the twin and conflicting aims of securing German social peace and extracting reparations. Along the way it became clear that although the Germans were supposed to pay, what they actually did was to borrow more and more. Eventually President Hoover called a "moratorium" on international debt payments, including Germany's, in belated recognition of an obvious truth. The Nazi regime soon enacted a series of measures that blocked transfer on much of its debt, a move that amounted to a partial default. After a second world war a completely prostrate Germany agreed to make partial payments on the earlier debts in return for the access to

¹ Throughout I refer to "default" on the debt. In some cases the German government simply blocked transfers into other currencies. Most accounts see that as partial default and refer to it as such.

international capital markets that it needed to rebuild its destroyed economy. The German government that negotiated this agreement, however, successfully argued that it should not have to assume the obligation for the entire debt since it only represented what was then West Germany. Thus what became known as the London Debt Conference of 1953 stipulated that some payments would be postponed until such time as the two Germanies were reunited. Those obscure notices about new German bonds were announcing the financial end to Europe's second Thirty Years War.

Our discussion will focus on the London Debt Agreement, and thus on Germany and its economic history. But the issues raised here resonate more widely, and in fact are debated today in different contexts. Following the Latin American debt crisis of the 1980s and 1990s, economists became interested in why sovereign debtors are ever trusted to repay their debts. This is closely related to a question that arises in the present context, which is why a country might default on its debt but then later repay. The London Agreement entailed a large reduction in Germany's outstanding debt. Activists today advocate forgiveness of debts owed by many of the world's poorest countries, and they sometimes point to the London Agreement as a precedent for their case. Finally, and related to the second point, a recent literature argues that it is both morally and economically appropriate for international financial institutions to refuse to recognize the legitimacy of "odious debt," debt incurred by a repressive or corrupt regime. We discuss the relevance of all these points to the German case in concluding.²

² Buchheim (1986, p.222) notes that there is little historical literature on the London Debt Agreement, which is surprising given its importance to Germany's post-war economic success. The silence on this topic is indeed puzzling. Konrad Adenauer, the first Chancellor of the Federal Republic, had as his main foreign policy aim the re-integration of Germany into western economic and defense agreements. The London Debt Agreement was a central, early step in this process, but receives only peripheral comment from Adenauer's biographer. Schwarz (1995, 1997) mentions the agreement only in passing, in, for example, a lengthy discussion of the reparations to Israel, or remarks on Adenauer's desire to have Hermann Abs play an important role in the government of the Federal Republic. Adenauer has a bit more to say on the subject in his memoirs.

The new bonds issued in 1990 are also interesting in a narrow financial sense. They represent an unusual type of contingent obligation. Contingent obligations are common in corporate finance, but have rarely been issued by governments. The problem for governments is that they usually have too much influence over potential triggering events, inducing moral hazard. A government might like to issue a bond with a provision that allows it to delay repayment if tax receipts are too low, for example. But it is too easy for a government to allow tax receipts to fall for any investor to find this security very attractive. What makes these German contingent obligations especially interesting is that they represented a sensible approach to a sticky problem when first agreed to in 1953. The event that would trigger repayment of part of Germany's debt, the re-unification of the country, was largely outside Germany's control. One of the problems poisoning the international financial system throughout the 1920s and 1930s was debate over whether Germany was able pay its debts. Another was whether Germany was intentionally making itself unable to repay its debts.

The background: war and reparations

The Nazis disavowed responsibility for several different types of loans. To the regime, these loans shared the common feature of reflecting Germany's weakened position after World War I, including the terms of the Versailles Treaty itself. But the sources of the different debts were viewed as politically important to later generations, as reflected in the post-World War II settlements. Not all of these debts were actually included in the London Debt Agreement of 1953, but to understand Germany's financial position we need an overview of the entire situation.

War debts

The countries that fought World War I all had trouble financing their enormous military expenditure out of taxation. Each resorted to inflation and to extensive borrowing, although in different proportions. At the end of the war, all belligerents were suffering the effects of inflation

(albeit disguised by rationing schemes) and from the need to service the enormous government debt built up during the war. Estimates of the total debt amassed during the war differ slightly, but one set of figures implies that Germany spent eight times as much in the period 1914-1918 as it raised in tax revenues; France, about seven times as much; Britain, nearly four times as much; and even the United States, which had played only a slight role in the conflict, spent nearly three times as much as it raised in tax revenue (Hardach 1977, Table 21, p.155). France and Belgium, which had been the scene of the bulk of the fighting on the western front, had suffered great material damage to farms, factories, and other property. Countries that had raised large armies had made commitments to pensions for soldiers and their widows and orphans, meaning additional financial obligations in the future. Compounding the difficulty was the disruption to national and international economic life during and just after the war. The first two years of peace saw the near-collapse of the European economy.

This was the financial background for the reparation obligations placed on Germany by the Versailles Treaty in 1919. Germany had not experienced any physical destruction during the war, but otherwise faced the same problems as other belligerents, and also had to pay reparations. But the Germans faced a further burden. The Allies had been able to finance much of their military expenditure with loans from the United States. Some of the U.S. lending was intermediated through the United Kingdom and France, which borrowed from the United States and re-lent to other Allies. Germany's war debts were different. The other Central powers were poorer than Germany, leaving the Reich to play the role of financier. So most of its war debt was internal, that is, obligations owed to German citizens. The value of this debt was significantly reduced, but not entirely wiped-out, by wartime inflation and the hyperinflation that followed.

Reparations

At the conclusion of most European wars up to World War I, the defeated country had been forced to pay the victor. France had paid reparations that amounted to 15-21 percent of GDP

at the end of the Napoleonic Wars, for example, and at the end of the Franco-Prussian war she had paid an indemnity of about 25 percent of her GDP (White 2001, Table 5). During World War I, the civilian populations in all the belligerent states had endured severe hardships due to inflation, increased taxation, and shortages of food and consumer goods. Governments on both sides justified the privations by assuring their citizens that after the war, the other side would pay the financial costs of the war. Thus it was no shock when the Allies stated, in Article 231 of the Treaty of Versailles (1919), that Germany would accept financial responsibility for the war.³ For our purposes it is important to bear in mind that the Allies did not demand immediate payment in full. The reparations obligations were treated as another debt placed on Germany.

Those who supported the reparations demands made three arguments, none of which sounds very high-minded today. The first was the claim stated in the Treaty: the war was Germany's fault and she should pay for it. There is, in fact, a school of thought that attributes the outbreak and duration of the war to Germany's intentions and policies.⁴ The second argument was that the European Allies were deeply in debt to each other, to their citizens, and most of all to the United States. Default to any was implausible, and paying off the staggering debt without reparations income was politically unpalatable. Some at the time suggested that the United States should forgive most or all of the inter-Allied debt, a move that might have reduced the demand to extract reparations from the Germans. But such forgiveness was not forthcoming. Given that the U.S. expected repayment, the argument goes, France and the other Allied debtors would have to extract resources from Germany.⁵ The final argument in favor of reparations was historical: this was always the outcome of war. The Germans had imposed a huge bill on the French in 1871, and

³ The text of the treaty is available at: <http://history.acusd.edu/gen/text/versaillestreaty>.

⁴ The key text is Fischer (1967). The publication of this work in the German original in 1961 set off what is known as the "Fischer controversy."

⁵ Keynes made several distinction suggestions along these lines. In *The Economic Consequences of the Peace* (1919), he raised the possibility of canceling all inter-Allied debt, but in a tone that suggests he thought it politically unrealistic. He made two later proposals to the effect that the United States forgive all debts owed to it by its former Allies. See "Cancellation (1921)" and "Cancellation (1928)" in *Essays in Persuasion*.

it was self-serving for the Germans to plead that they should escape the harsh fate they imposed on Russia at the Treaty of Brest-Litovsk in 1918, and which they would have visited upon the Allies had the military situation been reversed.

Opposition to the reparations provisions of the Treaty took several forms, most of them spelled out by Keynes in his famous polemics.⁶ The first line of attack was that reparations were inconsistent with the spirit of Wilson's Fourteen Points.⁷ A second line of opposition turns on the nature of German constitutional arrangements after the War. During the war many elements in Allied countries had blamed the war on Prussian militarism and on the undemocratic nature of the German Reich. After the war the Kaiser abdicated and fled, and the new Weimar constitution elaborated a parliamentary democracy with clear lines of ministerial responsibility leading to elected representatives. The government that started and prolonged the war, that is, was gone, and by forcing the Weimar Republic to shoulder the obligation of war reparations, the Allies were at best saddling it with a debt it never incurred, and at worst punishing the German people rather than their government.

These two arguments would pertain to any form of reparations, no matter how small and symbolic. Many critics such as Keynes attacked the reparation demands on more specific grounds. First, the Treaty did not name a specific figure that Germany would have to pay. Rather, it said that the Allies recognized Germany could not afford to pay for all the damage it had done, and created a Reparations Commission to assess the German economy's ability to make payments.⁸ One could view this mechanism as a way of delegating a very technical set of

⁶ The first of these, *The Economic Consequences of the Peace*, was quite influential at the time and is much better-known today than the second, *A Revision of the Treaty*. The latter is the more reasoned, dispassionate work.

⁷ Wilson demanded that Germany evacuate and "restore" all occupied territory. The pre-Armistice Agreement, which the Allies accepted and Germany thought would form the basis for the Treaty, opened the door to broader compensation. In Wilson's eyes, and those of many who accepted the Fourteen Points, the Versailles Treaty went beyond "reparations" in the sense of compensation, to "indemnity," a punishment.

⁸ The Treaty names a figure to be paid immediately, which was only a small fraction of the total reparations demand.

questions to a council of experts better-qualified to study the question, and in fact some of the Allied representatives intended just that. But the Treaty was silent on even the most general criteria for defining Germany's ability to pay. Second, when the Reparations Commission did begin its work, it became clear that the amounts contemplated included items (such as support for the widows and orphans of those killed on the Allied side) that had not previously been understood as a cost of war.

Several scholars have attempted to estimate the burden to the German economy of actually paying one of the sets of reparations demands made during the 1920s. The exercise, while interesting, is entirely hypothetical. Germany only briefly tried to pay the reparations bill. In fact, until quite late in the game no actor had a clear idea of the total size of the bill. (The London Schedule of Payments promulgated in April 1921 did set down a specific figure. But much of that was explicitly conditional – Germany would only pay the lion's share named there under fairly implausible conditions – and even the part that was not supposed to be conditional was uncertain, in the sense that Germany had good reason to think that it could get the bill reduced.) The damage to Germany came as much from uncertainty about reparations as from any payments burden. Business investment requires a stable, predictable environment. In the absence of a fixed plan for dealing with the reparations matter, investors, both German and foreign, had to worry that the government would increase taxes to meet the obligation, or that Allied countries would simply confiscate German assets. More importantly, the lack of a precise payment scheme created moral hazard at both the political and economic level. German leaders knew that if they succeeded in extracting resources from the German economy to make reparations payments, they would just whet the Allied appetite for more.

Some historians and several important political leaders at the time thought that political moral hazard was one important element behind the crisis and hyperinflation of 1922-23. The Erzberger tax reforms of 1919-1920, while fulfilling Allied demands in spirit, contained serious loopholes and did not raise German tax revenues rapidly enough to avoid a series of "Fulfillment

crises.” Germany was not been forthcoming with reparations, and the French and Belgians, as was their right under the Treaty, occupied the Ruhr, one of Germany’s most economically important regions. The idea was to force the German government’s hand in the long term, and to extract resources in the short term by trying to appropriate coal directly at the pit-head. In response, the German government initiated a policy of passive resistance. Workers were encouraged to stay home, and the government aimed to support them with special grants. Inflation had already been running at elevated levels. The effort to print more money to replace lost Ruhr revenues and support German striking workers led to hyperinflation.⁹

There are two lines of interpretation for these events. One stresses the impossible position of the German government, trying to secure democratic legitimacy while facing incompatible fiscal demands. The other sees in the German reaction to the Ruhr occupation an effort to show the Allies that Germany could not be forced to pay reparations against her will. A middle view might note that inflation and the wild spending that created it served various domestic purposes, not least drastically reducing the real value of Germany’s internal public debt and helping to prevent right-wing victories in crucial elections. Under this interpretation, staving off reparations

⁹ Bresciani-Turroni (1937) contains both a clear narrative of the relevant events in the 1920s and an analysis that, while not fully shared by modern writers, remains an excellent starting point. Feldman (1993, Chapter 8) conveys quite effectively the nuances of the bad behavior and mixed motives on both sides. As he notes, “A misleading case can be made that the Germans had not acted in good faith in the negotiations and discussions that took place between July 1920 and May 1921. In its extreme version, this charge neglects both the very real efforts that the German government had made to reform its taxation system, increase production, and reduce expenditure as well as the powerful domestic constraints preventing post-Revolutionary German governments from being as forthcoming in their negotiations with the Allies and as effective in their fiscal policies as the situation demanded. Nevertheless, the criticisms of German behavior are not without basis and cannot be dismissed. One need turn neither to critical historians nor to Allied polemics for such an argument. The Germans provided enough testimony of their own.” (p.344) In one such example, he quotes a report to the Reich Economic Council in 1921: “I have found increasing evidence from my discussion with the Tax Office Chairmen and the Presidents of the State Finance Offices, that in these rather important positions the view is widely held that it is not our duty to carry out tax laws to the maximum. It is in the interest of our people that we retain certain reserves, that we do not yet extract all that we can throw into the mills of the Entente. This view is actually there and has influence.” (pp.349-9). Schuker (1978, pp. 355-358) shows that Wilhelm Cuno (Chancellor) and Walther Rathenau (Foreign Minister) at least saw the situation in 1922 as offering Germany a way out of the Treaty.

demands was a nice bonus, but not central to the coalition's political calculus. The fact that the reparations requirements had both explicit and implicit contingent features is sufficient to sustain that *suspicion* in this and later crises. Sometimes suspicion of moral hazard is enough to generate undesirable outcomes.

The transfer problem

Keynes raised another objection to the reparations scheme, one which has unfortunately come to dominate much subsequent discussion among economists. Suppose there had been agreement on all sides on what Germany was to pay. Would it have been *economically* possible? One can think of the reparations as posing two distinct problems. The first is the German government's ability to raise the amounts required via taxation. The second is the economic problem of transferring those resources abroad, that is, into another currency. Keynes argued that what has come to be called the "transfer problem" would have made reparations more difficult than they would at first seem. Germany had few remaining assets overseas, and one of the Reparations Commission's first actions was to transfer those to Allied control. Transferring reparations payments required selling more German goods and services abroad than the goods and services Germans purchased abroad, that is, a trade surplus. But how would this be possible? Post-World War I Europe faced high unemployment, and most countries were reluctant to open their markets to German goods. Keynes argued that in trying to sell large amounts in the markets open to them, the Germans would drive down their terms of trade and thus make the payment of reparations even more difficult. There ensued a long and not terribly fruitful debate among economists about this so-called "secondary burden" of reparations.

Most of the discussion of the reparations and the transfer problem has ignored two other possibilities. Germany did not need to transfer resources internationally; the government could have raised the revenue domestically and then used that revenue to purchase *German* assets that it would then assign to the Allies. That is, France could have ended up owning a portfolio of

German industrial assets. This would be a slightly kinder tactic than what happened after World War II, when the Allies, especially the Soviets, simply took over German plants to operate for their own ends (see below). The Germans actually proposed a different alternative to reparations transfer, which was to make good the war damage in France and Britain directly. This would have amounted to the export of German labor (and some capital). The idea of thousands of Germans working in France and Belgium in 1921 was political unpalatable, and this option was never taken seriously.

The transfer problem remains an interesting *theoretical* issue in the context where it arose, the reparations after World War I. But the Germans never made significant reparations payments. Even Keynes would agree today that the transfer problem is irrelevant to the way the Versailles reparations worked out. It is directly relevant to the London Debt Agreement, on the other hand, because that agreement was crafted with the transfer problem clearly in mind.¹⁰

Schuker (1988) has rightly noted that opposition to the reparations is now part of a consensus that emphasizes a shared responsibility for the rise of Hitler and the second World War. Many discussions of the reparations miss an essential point. The first bill presented to Germany, by the London Schedule of Payments (1921), was for 132 billion (gold) Marks.¹¹ Of that, however, the German government was to begin service on two series of bonds (the so-called “A” and “B” bonds) totaling 50 billion Marks. The Reparations Commission was empowered to

¹⁰ The reparations are at the center of another line of argument that is not directly relevant to our concerns. One explanation for the severity of the Great Depression in Germany turns on the government’s lack of “room to maneuver,” the policy instruments that other governments used with some success to reduce unemployment and increase output. The debt overhang created by the reparations, along with the restrictions on Reichsbank activity imposed by the Dawes Agreement, meant that Germany could not reflate her way out of the Depression. The larger debate is usually referred to as the Borchardt Debate, after Knut Borchardt. Ritschl (2002) analyzes the implications of Germany’s debt position, including the reparations obligations, and discusses the implications for the Great Depression.

¹¹ Throughout this paper I use the term “Mark” to denote the German currency of the day. At the pre-World War I parities, \$1 gold = 4.2 gold Marks. One Mark was worth one shilling sterling. After stabilization in 1924, the new Reichsmark once again traded at \$1 = 4.2 RM. The Deutsche Mark re-established in 1948 after another round of wartime (and post-war) inflation at first traded at 3.33 to a dollar, but then fell to the old parity of \$1=4.2 DM.

issue “C” bonds for part of the rest of that 132 billion Marks, but the Germans would have to service these bonds only if the Commission concluded that the German economy was able to bear this further burden. The “C” bonds had some political significance, as Schucker (1988, p.17) notes, but no serious observer ever expected them to be issued or serviced. Belgium’s premier noted that such bonds could be put away “without bothering to lock up, for no thief would be tempted to steal them.”¹²

Service on the “A” and “B” bonds was set at 2 billion gold Marks per year plus 26 percent of the value of Germany’s exports. Thus the original demands were scaled to some idea of Germany’s ability to pay, or at least make transfers. The two later reparations-related loan schemes, the Dawes (1924) and Young (1929) plans, each reduced this sum considerably. The 50 billion Marks figure exceeded Keynes’s estimate of the “feasible maximum” Germany could pay by about 25 percent. In the end Germany paid about 23 billion Marks in reparations, not much more than half of what Keynes thought it could pay.¹³ What ensued instead during the period from 1924 through 1933 was a system whereby international lenders, mostly American, lent money to public and private entities in Germany, which in turn used it to make reparations payments to the European Allies. The European Allies receiving the reparations payments used them, in large part, to repay their debts to the United States. External loans to German governments enabled them to function in the face of rising expenses and a weak tax base, and some financed improvements in the lives of ordinary citizens that made other features of life in the Weimar Republic more palatable. External loans to private entities, mostly German businesses, financed new production that kept people employed and provided tax revenue to governments. So long as the funds kept flowing, the system worked. The Great Depression ruined

¹² Quoted in Schucker (1988, p.17).

¹³ Keynes (1971a, p. 200) concluded that the most Germany could possibly pay was \$10 billion, or about 40 billion Marks. Mantoux (1952) is a sharp criticism of Keynes’s writings on the Treaty of Versailles. Not all of Mantoux’s discussion is fair, but he demonstrates convincingly that Keynes under-estimated the German economy’s ability to pay reparations. Schucker (1988, Table 12) estimates that Germany actually paid 22.89 billion Marks through 1932.

the international financial system that made these flows possible, and the Germans defaulted. At that time they owed American lenders more than they had paid on the reparations bill, which led Schuker to title his study “American Reparations to Germany.”

The debts covered by the London Agreement

The London Debt Agreement covers a number of different types of debt from before and after the second World War. Some of them arose directly out of the efforts to finance the reparations system, while others reflect extensive lending, mostly by U.S. investors, to German firms and governments. By 1932, when Germany began to default, its international financial obligations were enormous. About 40 percent of total external debt, or 8.4 billion Marks, was owed to the United States in that year. Three other creditors, the Netherlands, Great Britain, and Switzerland, account for another 40 percent of total external debt (Klug 1993, Table 2).

The Dawes and Young Loans

The Treaty and the Reparations Commission took in payment for reparations some physical assets such as ships and marine cables in the period 1919-1921. The Commission also required Germany to make coal deliveries to France and Belgium, for which she was credited. But Germany did not make all the required payments in 1921 and 1922. This was, in part, because of difficulties in reforming the tax system to raise the required revenue, but also because of the hopes of some in Germany that stalling on payments would get the bill reduced. The several fulfillment crises of this period reflected both conflict with Germany and disagreement among the Allies. The Allies had never agreed on the wisdom or necessity of reparations, and it was not unreasonable for German leaders to think that a policy of delay and division might lead to them being reduced or even cancelled.

The Dawes committee, named for Charles G. Dawes, the former director of the U.S. Bureau of the Budget, proposed a new approach in April, 1924. The Dawes plan was to raise an

international loan of about 800 million Marks that would allow Germany to stabilize its economic situation, and at the same time to reschedule reparations payments to reduce the immediate burden considerably. The Dawes plan also placed the Reichsbank under international supervision to strengthen its independence from the government, a move intended to reassure lenders there would not be a second period of hyperinflation. An important innovation in the Dawes plan was its separation of payment from transfer. The new system required that the German government raise tax revenue to pay for reparations, but placed decisions about transfer in the hands of an Allied agent.

The Dawes plan at first worked even better than had been hoped. This success was the result, in part, of a flood of international lending, primarily from the U.S., that followed from the apparent solution of the reparations problem. That lending is discussed in the following two subsections. By 1928 the agent supervising reparations payments on behalf of the Allies, Parker Gilbert, worried that the German government was becoming fiscally irresponsible again. These concerns led to another conference in 1929 under the chairmanship of Owen Young, an American lawyer and businessman who had earlier advised the Dawes committee. The resulting Young plan, which was intended to be final, involved another loan (this time of 1.2 billion Marks) and a short-term reduction in reparations payments. Unlike earlier plans the Young plan fixed a definite, unconditional sum Germany would have to pay.¹⁴

The Germans had counted on the Young plan as a way to obtain easier conditions from the Allies. Their efforts partially backfired; although the annuities due under the Young plan were reduced somewhat, reparations once again were unconditionally transferable. The Young plan lasted only a brief time, as the world depression overtook events. President Hoover proposed a one-year moratorium on all war debt and reparations payments at the end of June, 1931, and in June of 1932 the reparations debts were cancelled. The Young Plan was a disaster for all

¹⁴ This agreement also established the Bank for International Settlements in Basel, Switzerland, to act as agent to receive and disburse the payments.

concerned. Hitler revived his failing political fortunes largely by campaigning against it, and what was intended as a final settlement was, even at the time, clearly not.

Business loans

The London Agreement covered two conceptually different types of loans to German business. The first consisted of the type of loans any investor might make. Germany suffered virtually no physical damage during the war. But by 1919 the German economy was in a bad way due to shortages of labor and raw materials, several years of neglected investment and repair, and severe shortages of working capital. The Allies found themselves in the curious position of wanting to extract payments from the German economy but recognizing at the same time that to do so would require restarting an economy with loans. The U.S. for its part had gone from being a large net debtor at the start of the war to being a large net creditor at the end of the war. Germany was a fruitful field for U.S. investments, especially after the Dawes plan.

A second, special category of loans to business was covered separately by the London Agreement. During the 1931 banking crisis, some foreign creditors, mostly banks, agreed not to try to repatriate their money. This helped stave-off default in Germany. The first such “Standstill” agreement was signed on September 19, 1931, and was intended to run for six months only. It froze existing credits (with continued interest payments) in the amount of some 6 billion Marks (Forbes 1987, p.575). These agreements were renewed repeatedly through the 1930s, but with smaller and smaller credit lines, as the depreciation of the pound and the dollar reduced the Mark value of the loans, and as some lenders were able to get part of their money back. Thus the Standstill credits were never intended to be long-term loans; they were originally short-term credits that were frozen into place by the repeated Standstill agreements.

Loans to German governments

Once international lending got under way after World War I, the several levels of German governments went on a borrowing spree. The Reich's only significant loans were the Dawes and the Young; the real profligacy was elsewhere. The Weimar constitution enhanced Germany's federal character. Throughout the 1920s, each German state (*Land*) had considerable fiscal autonomy, including the right to float loans in Germany and abroad. The same was true at a different level for Germany's cities. Debts from World War I and debt due to reparations obligations were clearly the duty of the federal or central government. But this entity had, at first, no direct control over borrowing by state and city governments. By the late 1920s state and local borrowing had become enormous. The size of the total government debt was a cause for concern to the Reichsbank as well as the reparations authorities because service on this debt potentially placed strains on Germany's transfer capacity.

The public-sector debt had two sources. One was the ballooning size of government spending overall. After the war the government tried to buy social peace by continuing wartime subsidies of food and transport, and later by pushing through increases in public-sector salaries that were not sustainable given the tax system. As James (1986, p.39) notes, the fraction of all income spent by the state rose from about 14.5 percent prior to the war to 24 percent in the second half of the 1920s. This problem appeared at the federal level and in several of the states, including Prussia, by far the largest.

Municipal borrowing reflected a desire to improve the living conditions of urban-dwellers who had suffered through years of war and chaos. Cities borrowed to improve transportation and other public infrastructure, and in some cases to provide public cultural and sports facilities. A less healthy part of this borrowing was undertaken to finance the construction of facilities such as harbors intended to lure companies from one city to another, or simply to feed the grandiose visions of city fathers. These debts were enormous. Almost 12 percent of all foreign loans issued in the United States between 1924 and 1929 went to German cities (James 1986, p.95).

Post World War II assistance

Another class of debts covered by the London Agreement arose out of assistance to Germany after World War II. Both Britain and the United States provided assistance, but the bulk of this debt was to the U.S. government. There were two main programs. Government and Relief in Occupied Areas (GARIOA) had begun shortly after the war with the intention of providing for immediate needs, including food, fuel, and medical supplies. The Marshall Plan (technically, the European Recovery Program) operated in the period 1948-1951, and was intended to foster long-term recovery through investment in productive facilities. Both of these programs included a substantial grant element, but in both cases some of the assistance rendered was in the form of loans.¹⁵

Transfer stops and default

The path to default reflected both political and economic realities, but can only be appreciated in the economic context of the day. The Great Depression was even more severe in Germany than in the United States. Given that it began during the Weimar Republic's death struggle, all possible economic policies open to German leaders were either constrained or colored by their political implications. A long tradition in German economic historiography essentially blames the rest of the world, in particular the United States, for the severity and duration of the Depression in Germany. Even without accepting this view in full, we can note that the almost complete lack of international cooperation in this period made Germany's difficult position impossible.

The Lausanne Conference had formally ended on July 9, 1932, with an agreement to end Germany's reparations obligations. As a face-saving gesture, Germany deposited with the Bank for International Settlements bonds worth 3 billion Marks. (The 3 billion Mark figure was in lieu

¹⁵ Milward (1984) is a good economic history of the immediate post-war period.

of all other reparations payments, and so reflects a trivial fraction of the original reparations demands). The Bank was to issue these bonds if, three years later, it judged Germany able to make the payments. The bonds were never issued, and the Bank burned them in 1948.

But this agreement did not deal with the more fundamental problems of the international financial system in the midst of a worldwide depression. The United Kingdom and France effectively defaulted on their war debts to the United States in late 1932, although Britain paid one final installment in June 1933, in an effort to draw the United States into international cooperation. The World Economic Conference of 1933, an effort to achieve agreement to cooperate on a broad range of issues including international debt payments, was a dismal failure, leading Germany to follow its own path. Exchange controls had been put in place starting in 1931, and these controls became a central feature of economic policy as the depression wore on, and the Nazis took over. The policies used to limit debt-service during the 1930s were on the one hand specific to the debt, but on the other hand part of the larger policy of using exchange controls to distort trade flows to suit the German government's aims. The policy did not operate in isolation; the devaluation of major currencies in the early 1930s meant that the Mark, which could not follow suit, was seriously over-valued, putting German exporters at a disadvantage.

The new Nazi government did not declare open default, but pursued a complicated policy motivated less by respect for the sanctity of debt than their need to maintain trade ties with their creditors. While making loud distinctions between “political” and other debt, the Nazi regime and its central bank treated both quite similarly. In what follows it is important to bear in mind a distinction between a straight default, in which the debtor announces their intention to stop paying their obligations, and a transfer stop. Under the latter, the creditor continues to receive payment but is prevented from converting the payments from Marks to another currency. A transfer stop works like a partial default, because it reduces the value of the payments to the creditor, but in principle is not a default. German policy first relied on transfer stops, and then outright default on the debt. A further complication in the story involves the German

government's use of the debt-service obligations to help subsidize German exports. Devaluations of the dollar, sterling, and (later) French franc increased the Mark's value by over 60 percent with respect to these currencies of major trading partners. The German policy worked to subsidize exports at the expense of Germany's creditors.

Schuker has noted that the nature of the debt outstanding in the 1930s afforded the Germans an opportunity to drive a wedge between groups of their creditors. Hjalmar Schacht, the once and future Reichsbank president, argued that Germany was unlikely to be able to access additional long-term debt in the climate of the day, and advocated a policy of preferential service of short-term debt. The short-term debt was more British and relatively more of it was owed to banks, as opposed to individual bondholders, giving the Germans two ways to split their creditors. On July 1, 1933, the Reichsbank president announced that henceforth only 50 percent of debt service for bonds would be paid in foreign currency as required; the rest would be paid in special inconvertible scrip issued by the Reichsbank. Creditors could sell this scrip to the Golddiskontobank for 50 percent of its nominal value in convertible Marks (thus effectively accepting a 25 percent reduction in their payments) or hold onto it against vague promises of full redemption in the future.¹⁶ In 1934 the Reichsbank created the so-called funding-bond scheme. Creditors agreed to exchange the payments owed to them for funding bonds that paid a 3 percent rate of interest. The funding bonds did not affect the principal of the underlying obligations, and the promise was to pay off these bonds eventually – the date given was January 1, 1945! – so this was not technically a default, either. But they did effect a considerable reduction in the value of the debts to the creditors. The Dawes loan, for example, had a 7 percent coupon rate, so creditors under this scheme received only 3 percent of 7 percent, or .21 percent annually on their investments.

¹⁶ The scrip was then made available to German exporters at face value, to subsidize exports and thus partially offset the over-valuation of the Mark. For the rest of this story, which is not central to the issue of debts per se, see Irmeler (1976) and Ebi (2003).

Klug (1993) provides an overview of an interesting wrinkle in the entire German debt process. Throughout the 1930s the German government, as well as private firms, bought back their own debt as it traded on international markets. Klug (1993, p.21) estimates that about 32 percent of the total external debt was repurchased by January of 1937, by which time the repurchases had dropped off. This strategy partly reflects the relative depreciation of the dollar, pound, and other currencies. A strong Mark made Dawes and other bonds cheap. But the larger strategy is one that could only be pursued successfully in secret; if others knew the German government was buying-back bonds, they would have bid up the price, obviating the Reich's intentions. Much of Klug's efforts go into constructing accurate estimates of the total volume of buy-backs. The German government at the time provided deliberately false information about these activities, and other agencies, such as the U.S. State Department, did not pay sufficiently close attention to provide accurate counter-estimates.

The Germans continued to use divide-and-conquer strategies, with only limited success. In 1934, for example, Germany defaulted entirely on the Dawes and Young loans, but after threats from the United Kingdom restarted service on the *UK* tranches of the loans (James 1986, p.407). Other special arrangements were made with the Swiss in return for trade concessions. Nazi economic policy was to move Germany into what amounted to a barter arrangement with the rest of the world, and the debt payments became one of the chips Germany had to offer. As Schuker (1988, pp. 69-81) notes, these moves were just one example of a larger strategy that offered partial payments to some creditors, but ultimately ended in default: "Instead of defaulting at once, Schacht stretched out the process over three agonizing years..." One challenge for post-war negotiators was cutting through the fog created by the Reich's complicated efforts to reduce its debt payments. "...the Reichsbank president [Schacht] did not neglect the practicalities of

expropriation. He exhibited no little originality in offering various forms of scrip and promissory notes (all later virtually worthless) in lieu of interest.”¹⁷

The London Debt Conference

The discussions that eventually led to the London Debt Agreements in 1953 had their roots in both politics and economics. At a political level, the three western powers (the United Kingdom, France, and the United States) in 1949 brought the three western occupation zones together into the Federal Republic of Germany (or “West Germany”). West Germany did not yet have full sovereignty, however, and one of the obstacles to its full independence was the outstanding issue of the defaults of the 1930s. As the legal successor state to the defunct German Reich, West Germany recognized its responsibility for the state debt. The Federal Republic also accepted responsibility for ensuring the payment of private debts, which strictly speaking was not its responsibility as the Reich’s successor state. In a response to the Allied High Commissioner dated March 6th, 1951, Chancellor Adenauer accepted responsibility for the debt and signaled Germany’s intention to repay, but reiterated two points that were important bases for the conference. First, the repayment plan must have “the objective of normalizing the economic and financial relations of the Federal Republic with other countries.” Second, “it will take into account the general economic position of the Federal Republic, notably the increase of its burdens and the reduction of its economic wealth.”¹⁸

Normalizing Germany’s financial relations with the rest of the world was probably the paramount motivation in Adenauer’s eyes. The German economy we know today would not be possible without extensive credit ties to foreign countries and institutions, and McCloy, the American High Commissioner in Germany, had made it clear as early as 1949 that the Germans

¹⁷ Both quotations appear on p.75

¹⁸ “Agreement,” Appendix A, p.112. Note that page citations are to the version of the agreement printed in the British parliamentary papers. The U.S. version was printed as a Senate document for the first session of the 83rd Congress.

could expect no additional private credits until the earlier debt had been dealt with (Abs 1991, p.55). But there were other carrots involved. The Federal Republic began its life as an occupied country. Allied officials made it clear from the start that a solution to the debt problem was necessary in order to end the occupation and the limitations it put on the Federal Republic's sovereignty (Abs 1991, p.64). From the viewpoint of fifty years later it is probably difficult to imagine that Germany was viewed at the time as an international deadbeat. Today Germany is viewed as one of the safest sovereign debtors, and the German economy is the recipient of many millions of dollars of foreign direct investment every year. But as Buchheim (1986, p.220) notes, at the time of the London Debt Conference most observers had in mind long years of what they viewed as Germany's irresponsible treatment of foreign debts and property owned by foreigners.

Adenauer accepted Germany's responsibility to deal with most, but not all of Germany's external debt. First, Germany would undertake to repay all public debt issued in Germany between the two World Wars, including the obligations of the central government, the several states, and municipalities. This included debts owed both to other governments and to private entities (investors who had purchased earlier German debt). Second, the Federal Republic recognized debts owed by German *private* debtors, so long as they lived in the Federal Republic. With respect to these debts, the German government accepted not the obligation to repay, but to establish mechanisms to ensure repayment. These debts had to be included in the overall plan because private debt payments would affect Germany's overall transfer abilities. Third, Germany accepted responsibility for debt incurred by the Austrian government during the period of *Anschluss* with Germany. Finally, the Federal Republic acknowledged its responsibility for repayment of advances under the Marshall Plan and other post-war recovery schemes. The eventual agreement specifically excluded several other types of obligations, including claims for damages arising out of the Second World War.

Issues

The nature of the debt was unusual. For this and other reasons, all parties to the discussions recognized that there were issues of equity and economics that would require agreement, and most likely compromise. Would the Germany of 1951 accept responsibility for debts issued by political entities that no longer existed? Prussia, for example, had been the largest of the German states prior to 1945, but was dissolved at Allied insistence at the end of the war. Repaying the *Reich* debt was only natural, given that the Federal Republic was the legal successor state. But the Federal Republic also accepted responsibility for the debts of Prussia, which no longer existed. Would the people of the Federal Republic be expected to repay *all* German debts, or would some be assigned, in theory at least, to the people of the fourth occupation zone, to the German Democratic Republic (or “East Germany”)? To the extent some debt was reserved for later, what would be the basis for the division; territory, former GDP, etc.? Most of the debt in question had not been serviced at all for many years. How much of the unpaid interest would be added on to the outstanding principal? Interest rates had been much lower through the 1930s than in the 1920s; what rate would be used to compound back interest? The debt had been issued in several different currencies, some of which had depreciated badly in the intervening years. How would the obligations be valued; that is, how many Marks would be paid to service each US dollar of debt, each French franc of debt, etc.?

Perhaps most obviously, it was recognized at the outset that Germany would not be expected to pay the full bill that would emerge from a purely technical reckoning of the outstanding debt. (The working parties that crafted the London Agreement did, however, go to great pains to work out a precise bill.) One important motivation for the debt settlement was to strengthen the German economy. Demanding that the Germans service an enormous debt was incompatible with that goal. In addition, some of the debt had been incurred under conditions that were politically sensitive. The Dawes and Young Loans were not, strictly speaking, reparations loans, but they might not have been needed in the absence of reparations. Demanding that the Germans repay

100 percent of such debts was not a sensible way to re-build German democracy and encourage attachment to the west.¹⁹

The entire agreement was crafted on the premise that Germany's actual payments could not be so high as to endanger the short-term welfare of her people or her long-term ability to rebuild a shattered economy and society. This basic understanding presupposed that the creditors would forgive some of the debt, agree to long repayment schedules for the rest, and be willing to re-negotiate terms if circumstances arose that made debt-service more onerous than originally thought. In this respect both the technical discussions and the political negotiations differed radically from the Reparations Commission set up in 1921.

Negotiations

Some of the logic of the London Agreement is only understandable in light of the way the negotiations actually took place. The only extensive account of the process that led to the London Debt Agreement is the book ghost-written in Hermann Abs' name (Abs 1991).²⁰ Abs was the leader of the German delegation at the conferences. His report is informative, but it is probably even more self-serving than most such accounts. Abs had good reason to portray himself in a favorable light. He was one of those Germans who had worked hard, and successfully, to construct the new Federal Republic, but he was never fully forgiven for his previous ties to the Nazis. He had worked closely with the Nazi regime as a manager of the Deutsche Bank, and later as a member of the *Aufsichtsrat* for many firms that dealt with German occupation of eastern

¹⁹ In a private communication, Stephen Schuker emphasizes that Dawes and Young Loans were supposed to have taken priority over all other Reich obligations, and that the U.S. government had pressured J.P. Morgan and Company to float the Dawes Loan. But in the London Agreement the U.S. tacitly colluded in ignoring the terms promised to the Dawes and Young investors. The point here is not whether the Germans should have had to pay X or Y after 1953; the U.S. and other governments were in effect forcing investors to shoulder part of the cost of a change in foreign policy goals.

²⁰ Also of interest is Schwarz (1982), which reprints speeches by Abs and the transcript of a meeting devoted to the 1953 London Debt Agreement.

Europe. He was briefly arrested after the war by the Allies as a war criminal, and in fact was convicted of war crimes in absentia by the Yugoslav government.²¹

Abs' account stresses that the negotiations were complicated and often rancorous. The different Allies had different objectives. The United States, early on, proposed simply forgiving all debt that arose out of assistance after World War II. This was not acceptable to the British, who were in much reduced financial circumstances (Abs 1991, p.102). The most serious disputes were not between governments, but between different classes of creditors, and between these creditors and their governments. These conflicts were implicit in the basic premise of the discussions, which was that Germany would not be asked to repay any more than she could afford. This premise, once accepted in effect created a fixed pool of possible repayment. Every Mark paid to a Dawes loan creditor would not be available to a Young loan creditor. Every Mark paid to the U.S. government in fulfillment of Marshall Plan agreements would not be available to private creditors. A striking illustration of this fact emerged when U.S. Senator Guy Gillette complained to the State Department that it was agreeing to a big write-down of post-war debt (owed to the U.S. government, that is, the taxpayer) to make more (German) resources available to repay private creditors (Abs 1991, pp.120-121).

²¹ In some cases, Abs was advancing the interests of the Deutsche Bank, and in other cases, taking advantage of "aryanization" policies to advance his own interests. The multiple roles he played in this period are astonishing. In 1938-39, Abs oversaw the sale of the assets of the Czech-Jewish Petschek family to, among others, Abs' own family. A post-war German court held that the Petschek's interests had been significantly under-valued. Abs played an important role in obtaining compensation for the Petschek's, and they in turn supported him in his own post-war legal difficulties (James 2001, pp.99-104). Abs later helped to negotiate the reparations that Germany paid to the State of Israel on behalf of Jewish victims of the Third Reich – victims, in some cases, of policies he helped to execute.

James's thoughtful and restrained remarks about Abs are well worth reading (James 2001, pp.215-217). As James notes, Abs' actions were always several removes from the actual death and destruction that were the consequences of his actions. And Abs could always, in truth, note that his actions were neither necessary nor sufficient to the producing the mayhem of Nazi Germany's economic rule. But he bears moral responsibility nonetheless, James insists. This nuanced rumination on Abs' role bears consideration in other contexts where historians are either too quick to condemn someone simply because they worked as part of a regime, or too quick to exonerate them, for the same reason.

The discussions and negotiations proceeded in four stages. The Allies began by setting up a “Tri-Partite Commission on German External Debt.” This Commission played a leading role, as government representative and moderator, in the negotiations. The Commission then worked with the German government to establish both which debts would be covered and how much they totaled, and to establish ways to determine Germany’s ability to make payments. These first talks were completed in Bonn, in June, 1951. In the second stage, the four governments were joined by representatives of private creditors from the United States, France, and the United Kingdom, as well as several central banks. These discussions, which were completed in London in July 1951, also included representatives of German private debtors.

In the third step, the actual debts and repayment schedules were negotiated. Here the parties split the government creditors from the private creditors. Most of the debt due to other governments arose out of post-war assistance to Germany, and thus was more recent and represented less difficult issues. Most pre-war debt, on the other hand, was owed to private creditors by both public and private debtors in Germany. The main conference for the negotiation of the debts owed to private parties, which took place in February, 1952, involved representatives of hundreds of private entities from 26 countries, including the three western powers moderating the conference. The German government played a dual role in these discussions, as both a party itself (because it would repay debts that arose out of earlier public issues) and as the entity that was to protect the interests of German private debtors as well as ensure that they honored any commitments that arose out of the conference.

The fourth step was to negotiate a parallel agreement covering inter-governmental debt, as well as to produce the detailed technical reports and agreements that would amount to the actual London Agreement. The final agreement was signed on the 27th of February, 1953, in London. The Agreement did not come into force without difficulty. The German Bundestag at first rejected it, taking offense at the apparent implication that repayment of France’s post-war aid amounted to an agreement that France’s occupation policy for its zone had been enlightened and

constructive, when most Germans saw it as otherwise. Under brutal American pressure, several Bundestag delegates then remembered that they had intended to vote the other way, and the Agreement passed on a second vote.²²

The Agreement

The agreement embodied three general principles: the amount Germany owed was reduced considerably; she was given a long period in which to repay; and the amounts owed in any given year were tied to her ability to make transfers. The value of the debts covered and the amount by which they were written down depends on the way the various currencies are valued. Most commentators agree that pre-war debts covered by the London Agreement of 1953 involved about 13.5 billion Marks, 7.7 billion of which was public debt. Unpaid interest on those debts amounted to another 2.6 billion marks. Post-war debts, which are conceptually easier to calculate, were about 16.2 billion Marks. The agreement reduced the total pre-war debt to about 7.5 billion DM, and the post-war debts to about 7 billion Marks. The German government agreed to repay a total of 11 billion Marks, of which 4 billion represented pre-war debts. Another 3.5 billion Marks was shared among private German debtors.

Under the calculations used in the London Agreement, the reduction in the total obligations, both public and private, was about 50 percent. A more standard commercial calculation leads to a far higher write-down, however. For example, 2.6 billion Marks of unpaid interest on 13.5 billion marks of pre-war debt implies a very low interest rate. Three percent of 13.5 billion Marks is 400 million Marks; if the Germans had paid that amount every year from the transfer stop of 1934 until 1953, even without compounding, the total interest would have been nearly 7.7 billion Marks. Precise valuation of the pre-war debt is greatly complicated by the several stratagems used during the transfer stop, and the exact amount of the debt reduction is not

²² Buchheim (2003) notes that this view of the French was less fair than it was widespread. An amusing recounting of the ratification maneuvers in the Bundestag can be found in Abs' comments printed in Schwarz (1982, pp.35-26).

our point. It is worth bearing in mind, however, that the London Debt Agreement required that Germany pay *at the very most* half of what she owed.

Agreements on the post-war debt were an inter-governmental matter, and on these the reduction in debt was a simple negotiation. The United States made this easy by writing-down much of the debt due to post-war assistance; the original U.S. claim of \$3.2 billion was reduced unilaterally to \$1.5 billion. Abs interpreted the U.S. offer as a threat to encourage a settlement of the pre-war debt. The U.S. offer was contingent on a satisfactory settlement of the pre-war debt, and made such settlement easier by reducing the transfer capacity devoted to its own demands (Abs in Schwarz 1982, p.22). The United Kingdom and France also agreed to smaller reductions of much smaller post-war aid debts. The U.S. decision doubtless reflects political calculations, as detailed below, but as a practical matter the reduction treated Germany on a par with other recipients of Marshall plan aid. About 15 percent of Marshall Plan aid to the United Kingdom and France was in the form of loans, which was about the same percentage of the German's aid once the London Debt Agreement had converted some German loans to grants (Buchheim 1990, p.70).²³

The reduction for pre-war debt was more difficult, and the agreement turned mostly on the gold clauses written into the original credit agreements. Gold clauses were a common feature of international loans in the nineteenth and early twentieth centuries. They protected the lender against inflation or currency depreciation. A loan made in 1910 with a gold clause would require that the borrower repay dollars with a gold value equivalent to a dollar in 1910. Article 12 of the agreement says that gold clauses were to be ignored for all loans issued in either U.S. dollars or Swiss francs. This innocuous language amounts to a devaluation of outstanding debt by about 40 percent. In 1925, a dollar was set by law at about 1/20th of an ounce of gold. The U.S. devalued the dollar in 1933, and after that a dollar was worth only 1/35th of an ounce of gold. Had the

²³ Dernburg (1953, p.301) puts the loan proportion much higher, at about 1/3. He does not provide a source and his figures do not agree with those of the official U.S. government sources. Hardarch (1994) is an account of the Marshall Plan in Germany.

clauses been honored in 1953, every dollar owed under a Dawes loan would have cost the German government 7.11 Marks. By ignoring the gold clauses, the Germans could repay in the actual dollars of the day, each of which costs them 4.2 Marks. The London Agreement essentially shifted the cost of U.S. devaluation back to the lenders, even though their debt contracts had explicitly protected them against such revaluations.²⁴

One reason to abrogate the gold clauses was legal. The U.S. Congress had nullified all gold clauses in (U.S.) domestic debt with a Joint Resolution on June 5, 1933. The U.S. Supreme Court upheld Congress' right to do so, meaning that all such clauses were henceforth meaningless in U.S. credit contracts (Kroszner 1999). This decision on the gold clauses did not settle the entire issue, however. U.S. law did not extend to other creditor countries, nor did it apply to debts owed by foreign creditors to U.S. residents (Dernburg 1953, p.303). Respecting it in some cases and ignoring it in others would result in vastly different valuations of the different tranches of a single loan, Young, that had been issued in different countries. (The Dawes Loan contained gold clauses only in its US-Dollar tranches, so the conference did not need to visit the issue in that context. All tranches of the Young Loan, however, had gold clauses.) In some cases a country's currency had depreciated so badly that ignoring the gold clause would strip that country's creditors of all their claims. An extreme example was Italy; the lira had depreciated 98 percent between 1930 and 1952.

The Agreement stipulated what amounted to a dollar clause: all debts other than those denominated in Swiss francs were valued as if they had been issued in dollars rather than the currency printed on the security. The dollar clause represents a convenient compromise. The

²⁴ The 40-percent figure assumes implicitly that the bondholder was given a dollar in 1934 instead of the equivalent amount of gold. The dollar had depreciated further in real terms by 1953, so the effect on the bondholder was actually much larger. Economic historians and macroeconomists still debate the implications of the devaluations of the early 1930s. But they certainly hurt Germany; the Mark became overvalued relative to other major currencies, hurting German exports. The gold clauses were a serious issue in the London Agreement only because the U.S., along with other major economies, had pursued a beggar-thy-neighbor policy in the 1930s.

dollar's depreciation against gold meant that this apparently technocratic decision achieved a very large reduction in German's debt. On the other hand, by using the dollar – rather than each currency of issue – as the valuation standard, the Agreement guaranteed that creditors in countries with badly-depreciated currencies would not bear a disproportionate burden from the gold clause decision. Abs (in Schwarz 1982, pp.29-30) presents the gold clause discussions as an especially difficult part of the negotiations.²⁵

Once payment figures were agreed, the conference arranged a repayment schedule that took account of Germany's situation. For the period 1953-1958, only interest payments were due. This delay in making payments on principal was intended to give the country some additional breathing room, and to recognize the reparations Germany had agreed to pay to the State of Israel, which were due at the same time (see below). Starting in 1958, the Agreement called for Germany to make annual payments, towards all debts public and private, of 765 million Marks. The 567 million Marks of interest payments due in 1953 were less than Germany's 708 million Mark trade surplus with the rest of the world. As Germany's economic miracle took off, she exported more and more, leading to ever-larger trade surpluses. By 1968 Germany ran a total trade surplus of 18.4 billion Marks. The fixed payments under the London Agreement became less and less significant. Some loans had been entirely repaid by the 1960s, and most of the agreement was satisfied by the early 1970s. The last annual payment due under the original agreement was made, as planned, in 1983.

Implicit in the Agreement (and explicit in discussions at the time, and participants' recollections after the fact) are several remarkable principles. One might think of the first as the "Keynes lesson." Whatever the actual motivations and ideas of the conference participants, they accepted that the major concern in such discussions should be a country's ability to generate trade

²⁵ Glasemann (1993b, p.29) notes that the agreement Abs describes only applied to the obligations of the Reich. Other Reichsmark-denominated obligations were valued in the same way only if they had a "specifically foreign character." Loans were deemed to have this character if they were issued under foreign law or were payable in a foreign location. If not, they were written down, with 10 Reichsmarks being paid off with 1 D-Mark.

surpluses sufficient to cover any payment obligations. Put more cynically, the Agreement implicitly assumes that reducing German consumption was not an acceptable way to ensure repayment of the debts. Thus the London Agreements were designed around a thoughtful solution to the transfer problem. This in turn required a radically equal treatment of all debtors, public and private. This equal treatment benefited some debtors at the expense of their creditor. Some of the German debtors were private firms that were already, or soon would be, profitable. Their own profitability was not at issue, however. The constraint was German transfer abilities, and this required external debt reduction even for entirely solvent private firms. This in some sense is the obverse of the situation during the early 1920s when at first German firms could not borrow abroad for fear that the fruits of any such lending would be indirectly confiscated by the German government, in the form of taxes, and applied to reparations obligations.

Reparations to Israel

This concern about transfer potential also shaped a second agreement undertaken by the Federal Republic at the same time. Early on Adenauer and other German leaders recognized that on both moral and practical grounds, Germany should make significant payments to the State of Israel and to Jewish groups in recognition of the horror the Nazi regime had inflicted on the Jewish people.²⁶ The State of Israel had named the sum of \$1.5 billion when it first raised the matter in a note to the Allied governments in March of 1953. Adenauer agreed, much to the disgust of Abs and his finance minister, in December of 1951. One billion dollars would go directly to the State of Israel, and another \$500 million would go to the Conference on Jewish

²⁶ A popular wisdom in Germany, Israel, and elsewhere claims that Adenauer's goals were pragmatic, even cynical. Adenauer, in his memoirs, stresses that the obligation to Israel was moral, and not an attempt to curry favor with the United States, or a reaction to a so-called "Jewish Lobby" in the United States. Adenauer's biographer agrees, stressing Adenauer's long-standing ties to the Cologne Jewish community when he was mayor prior to the Nazi seizure of power, as well as Adenauer's sincere horror at what had befallen the Jews at the Nazi's hands (Schwarz 1997). Wolffsohn (1988) demonstrates that whatever Adenauer's intentions might have been, he was not reacting to pressure from the United States or other western powers.

Material Claims Against Germany, which represented individual victims and survivors. The first steps towards negotiating an agreement of this sort started at about the same time as the London negotiations on commercial and government debt, and each constrained the other.

The timing of Adenauer's offer was terrible, from the German point of view. Abs' entire strategy in London had been to present Germany's ability to transfer payments as the binding constraint, effectively forcing the various creditors to compete against each other for every Mark of payment. Adenauer's agreement to make an additional very large payment to Israel and the Jewish organizations undermined Abs' argument; the creditors in London seized upon Adenauer's promise as evidence of bad faith, a greater ability to pay, or both. Abs consistently argued that all claims against Germany should be considered together, and at once, a position the Israelis made clear was unacceptable to them. Abs' approach might have left Germany with a smaller combined bill, but by implicitly treating the Israeli reparations as equivalent to the purely commercial and inter-governmental debts, it would have undermined the entire political point of Adenauer's approach.

Germany's discussions with Israel dealt entirely with the method of payment, which both sides eventually agreeing that most of the payments would be in kind, to spare pressure on Germany's trade surpluses. Given the nature of the obligation, the Germans could not quibble about the amount they would pay, and the Israeli side made clear that they would not bargain over the size of the payment. The Israeli side asserted the priority of their own claims over those of the ordinary creditors negotiating in London.

Abs's role in this aspect of the London Agreement is typically complex, and his version of events is less than frank. In his own recollections Abs coyly notes his reservations about the simultaneous timing but separate locations of the two negotiations (Abs in Schwarz 1982, pp.23-26). Adenauer (1966, p.141), for his part, notes that the German delegation in London – that is, Abs — showed little sympathy for the priority of the Israeli claims. In fact, on 19 May, 1952, Abs made an unofficial offer to the Israeli delegation that was so meager as to be completely

inconsistent with fulfillment of Adenauer's earlier promise. Abs so appalled the Israelis that Nahum Goldman, who had first discussed the matter with Adenauer, wrote to the Chancellor stating plainly that the Chancellor's honor and the trust of the Israeli government was on the line. Adenauer (1966, p.147) claims that he had no foreknowledge of Abs' offer. In his own memoir Abs does not mention the incident, although he does refer to a somewhat earlier conversation with Goldmann (16 May) in which Abs told Goldmann that either both negotiations (London and with the Israeli delegation) would succeed, or both would fail (Abs 1991, p.131).

Reunification

The Agreement did make Germany's repayments conditional on one event, and this was the event that triggered the additional payments in 1990. According to Article 25, if Germany reunified, the parties to the agreement would adjust the plan in three ways. First, and most importantly, certain specific features of the agreement would be implemented automatically. Second, the principles embodied in the agreement would be extended to private debtors in East Germany; that is, individuals and firms located there would be expected to make their own repayments. Finally, the specifics would be adjusted to take account of any loss of property in the east. This catch-all final rubric would allow some debtors to escape repayment on the grounds that they had lost their own property to the Soviet occupation or the East German regime.

The most important of these clauses was the first, which alluded to a series of sub-clauses buried in Annex I to the Agreement. These clauses allowed Germany to defer repayment of some of the back interest due on the Dawes and other pre-war loans until reunification. The logic of this clause was two-fold. First, at a political or moral level, it was not seen as appropriate to make the people of West Germany repay debts on behalf of the whole country, when part of that country

had evolved into a separate sovereign state.²⁷ This was true of loans such as the Dawes or Young loans, which had been incurred by a much larger Reich. It was even more true of the loans taken by Prussia, which no longer existed and whose former territory accounted for not much more than half of the Federal Republic as of 1953. Second, this provided a safe way of conditioning German payments on her ability to repay. Re-unification might have seemed remote or even impossible in 1953, but in any case few predicted that re-unification would occur as it did, with a nearly-bankrupt East Germany being taken over by the West. The Agreement contemplated a situation where re-unification meant that Germany could afford to pay *more*, not less.

The decision to make the contingent part of the payments equal to a part of the back interest was an artful compromise. A more natural procedure might have been to calculate the fraction of Germany's potential GDP that was lost because of the division of the country, and to delay repayment of that much of the debt until unification. The German delegation to the London conference actually produced a set of calculations intended to show the reduction in Germany's ability to pay due to loss of territory and resources. These estimates imply a debt reduction of between 40 and 50 percent, approximately the outcome of the London conference (Dernburg 1953, p.300). These calculations are hard to credit on simple factual grounds. East Germany was much smaller and less industrial than the western zones, and it is hard to believe that its loss could mean so much. A second objection to taking these calculations seriously is that they implied a larger reduction for the Prussian loans than for the Reich loans, because a larger part of Prussia was gone. For obvious reasons this approach was not acceptable to the creditors – especially those who held bonds issued by the now-defunct Prussia (Abs 1991, pp.179-180).

Each bond covered by this aspect of the agreement was split into two parts by the Agreement. One part was exchanged for a regular bond issued by the Federal Republic and

²⁷ The two Germanies combined, or the present-day Federal Republic, control only 66 percent of the territory controlled by the Reich in 1914 (that is, the government held responsible for World War I), and 76 percent of the territory left to Germany by the Treaty of Versailles.

served as called for in the agreement. The other, the back interest payments, was exchanged for a rights certificate (*Bezugschein*) that would, in case of reunification, entitle the owner to another bond for another set of payments. The Agreement was oddly vague about what constituted reunification, as Glasemann (1990, p.352) notes. In 1990, the Federal Republic could probably have claimed that unification with East Germany was not enough, that there were still missing provinces. But this would have violated the spirit of other international undertakings, including recognition of Poland's western border. The Agreement also gave Germany the right to demand new consultations about implementing the re-unification clauses, which presumably could have been used to reduce or escape the new payments altogether. But the total cost of servicing the new bonds issued at reunification was small compared to other costs of unification, and not worth raising problems with neighbors and allies.²⁸

The technical procedure whereby the *Schattenquote* was handled also offers an interesting lesson. As noted, the original bondholders were issued rights certificate, not bonds, for the *Schattenquote*. Abs (1991, p.183) notes the reason: the conference did not want Germany issuing tradable securities that would be a "thermometer" for the market's view of the chances of German re-unification. Such a security would not only be annoying to politicians (giving newspapers something simple and easy to quote as a way of conveying how each West German action supposedly affected the chances of reunification); it would open politicians and others to the chance of a peculiar form of "insider trading," or at least accusations of such.²⁹

²⁸ Glasemann (1993b, pp.53-54) estimates that the original *Schattenquote* obligations were valued at about 1 billion Marks in 1953. Through purchases of the warrants by the Debt Administration, this figure was considerably reduced by 1990. The remaining obligations issued in 1990 had a face value of 240 million Marks. Estimates of the total cost of German reunification to west German taxpayers vary widely, but even the low estimates run in the many hundreds of billions of dollars.

²⁹ Glaseman (1993a) claims that these warrants were listed on the Frankfurt exchange until the mid-1970s, usually trading at about 8 percent of their nominal value. Thus Abs' fear came true even with the warrants. Financial markets have a long history of annoying politicians. Abraham Lincoln tried to suppress the market for Greenbacks in the United States during the Civil War

The second part of Article 25 alluded to many different types of debts, the most important being municipal obligations issued by cities that were located in the former East Germany. Again, it would have been perverse to force the citizens of West Germany to repay debts incurred by Dresden or Leipzig, two cities located in the East. On the other hand, it would have been perverse to tell a creditor they were out of luck because they bought Dresden, rather than Frankfurt, city bonds in 1928. Thus the agreement in effect promised that when the Federal Republic's jurisdiction was extended to cover the former East Germany, the principles of the debt agreement would be similarly extended.

Contingency

Above we noted that one problem with the reparations schemes of the 1920s was that they made Germany's payments at least implicitly contingent. The contingent features of the 1953 Agreement, on the other hand, caused no trouble at all. Why? One difference is that the additional payments required by reunification in 1990 were tiny, compared both to the reparations burden of the 1920s and more appropriately to the cost to Germany of not adhering strictly to the agreement in 1990. But the key difference here lies in the absence of moral hazard. To be sure, West Germany could influence the probability of future re-unification. But from the debtors' viewpoint, all that matters is whether West Germany would seriously consider the additional debt under the London Agreement as a reason to refuse unification, or to reduce its efforts to bring this about.

Abs and other German participants in these discussions recognized the danger of a provision that would allow a general re-negotiation in case of reunification. The *Industriekurier*, an influential business publication, had called for Germany to assume *all* the debt, and not to allow the fact of division to cloud the country's reputation as a responsible debtor. Similar

because he was irritated by the daily "thermometer" reading on the progress of the war. See Willard, Guinnane, and Rosen (1996).

concerns had led Abs and the German delegation eventually to advocate provisions that would require definite, set actions on Germany's part, should reunification occur (Abs 1991, pp.181-182). Even after the agreement was crafted, Dernburg (1953, p.313) warned of

... the politico-psychological consideration that flexible arrangements, while suited to avoid formal defaults, might encourage a German successor government less willing to meet international obligations to create conditions that would make transfers impossible.

Today when we consider the economically powerful and fiscally responsible Federal Republic, it is hard to recall the bad feeling caused by Germany's treatment of foreign debt-holders in the 1930s. For this very reason, some have interpreted the debt obligations more broadly. Buchheim (1986, pp. 219-220 and 2003) argues that the debts in question were part of the new Federal Republic's "moral burden," the same obligation to break with the past that led Adenauer to advocate reparations to the Jewish state.

One final point of comparison is worth stressing: whatever the precise role of the Versailles reparations in the economic mess of the 1920s and 1930s, post-World War II reparations took a quite different, less damaging, form. At Yalta the soon-to-be-victorious Allies agreed that most reparations would be in the form of labor services and payments in kind. Abelshauser (1983, p.24) remarks that this decision showed that the Allies had learned only *one* lesson from the Versailles reparations, and he is right to stress that in the Soviet and to a smaller extent French occupation zones, the reparations extracted in this way seriously undermined the German population's ability to rebuild the economy and also created doubts about the Allies' eventual intentions. For the French and to a greater extent the Soviets, this was at first the point. Adenauer (1965, pp.247-248) noted that the Germans had no moral right to complain about the dismantling of factories and other efforts to extract reparations, but stressed that reparations activities were counter-productive on pragmatic political grounds. The western Allies quickly realized that it was absurd to extract reparations with one hand, while trying to feed the German population and restart the economy with the other, and gave up the practice. The post-World War

II reparations demands had an initial public shock effect similar to that caused by the Versailles negotiations, but by relatively quickly setting these demands aside, the western Allies made it possible for the Federal Republic to deal with its old debts.

Broader Lessons?

Discussions of Germany's debt experience naturally raise issues of more general intellectual and policy interest. The German case actually offers no clear-cut lessons on any of these matters, despite some claims made in the literature. Considering the German experience in light of these broader discussions is instructive, however, if for nothing other than highlighting the unusual circumstances of the London Agreement.

Sovereign Debt

Government borrowing and government default has been a part of the international financial scene for centuries, but when many Latin American countries had trouble repaying their debts starting in the 1980s, economists became interested in the general issues related to sovereign debt. The central puzzle is why any government ever repays, which is the same as asking why anyone lends to a government. Most debtors can be taken to a court, where they can be compelled to repay their debts. This is not true of a sovereign debtor. Eventually debate centered on two views. One, the reputation view, holds that sovereign debtors repay because otherwise they are cut off from international financial markets. This view implies that it is so important to be able to borrow today that a government might voluntarily repay a loan defaulted on many years ago. It also implies that lender B might refuse to make a loan until a country has repaid lender A, not out of any effort to protect A, but because B otherwise worries that the country does not take its debt obligations seriously. The other view, sometimes called the

“gunboats” view, says that sovereign debtors repay because of compulsion or its threat; creditors can organize trade boycotts or even impose military force.³⁰

The case of post-war Germany can be interpreted as support for either view. On the one hand, the Federal Republic was anxious to regain access to foreign credits to finance reconstruction and development. On the other hand, it was unusually susceptible to pressure as a still-occupied country. The discussions leading up to the Agreement and the language of the Agreement itself stress the first explanation very heavily.

Debt relief for poor countries

The London Agreement has been held up as an example of what should be done for countries in the developing world that have enormous debts and little capacity to repay. The World Bank’s Highly Indebted Poor Country (HIPC) initiative is currently pushing for reductions in the external debts owed by the poorest countries of the world. There are two arguments. First, “debt overhang” reduces the incentive to save and invest. Until the debts are repaid, the benefits of savings accrue to creditors, not the population of the debtor country. Second, debt forces poor countries to spend scarce resources on debt service (instead of education, health care, and other goals) and interferes with development goals.

Economists tend to be suspicious of these arguments, noting that most of the countries covered under the HIPC plan receive larger transfers from international agencies than they pay in debt service.³¹ But some activists today see in the 1953 London Agreement a blueprint for action along HIPC lines. The analogy often comes from Germans, who understandably view their country as the beneficiary of a debt write-down that should be extended to others. Philipp Hersel,

³⁰ English (1996) is an excellent study of default by U.S. states in the 19th century. He notes that most states that defaulted eventually repaid their debts, and argues that this case supports the “reputation” view. His paper contains both a readable summary and references to the main theoretical literature.

³¹ For surveys of these issues, see Bird and Milne (2003) and Arsanlap and Henry (2003).

for example, argues that the precedent set by the London Agreement argues for vast reductions in the debt-service obligations of many poor countries. His paper was distributed by a German group called “*Erlassjahr 2000 – Entwicklung braucht Entschuldung*.”³² Unfortunately, some of his discussion misrepresents the core ideas of the London Agreement. Lurking in the background of the London Agreement was the idea that Germany needed to be able to run trade surpluses *with the world* in order to service any external debts. Hersel, on the other hand, focuses on bilateral trade surpluses, in effect claiming that Chile should only repay debts to U.S. creditors to the extent Chile can run surpluses with the U.S. His argument would in fact preclude most international lending. But he is right that many poor countries today are being asked to service debt even when they have no trade surpluses. Countries in this position have to borrow more just to service the old debts.

So should the wealthy countries view the London Agreement as an implicit commitment to treat all debtors in the same way? Surely the London Agreement’s relative generosity reflects not abstract notions of justice, which can be applied to any situation on the basis of some sort of “precedent,” but two concrete facts of the German case. First, increasing tension with the Soviet Union had led to a strong desire to rebuild a sound, democratic Germany. Harsh repayment terms would not serve that end. When the U.S. decided to forgive much of Germany’s Marshall plan debt, in effect treating it on a par with other European recipients of that aid, it was just recognizing that what in 1945 had been a defeated enemy was now a valued ally.

A second point was also something Keynes insisted upon as a reason to oppose reparations. Prior to World War I, the German economy was central to the European economy as a whole; a healthy Europe could not exist alongside a sick Germany. The same held true after World War II. The German economy was so important to the world economy, and to Europe in

³² “Development requires remission.” This organization is the German branch of the Jubilee 2000 Debt Forgiveness movement. The document posted at <http://www.erlassjahr.de> in English is a shortened translation of the German-language seminar paper posted on the same site. Note the double counting in the translation at p.6, which does not appear in the German document. The author also mis-construes the abrogation of the gold clauses.

particular, that the country was in a strong position to demand concessions that would enable her to return quickly to her traditional role as the engine of the European economy. Developing-country debtors, unfortunately, rarely have such a favored political role, or play such an important part in the world economy.

Another suggestion, based upon provisions of the London Agreement, is tie a country's debt-service requirements to its ability to pay, perhaps by setting payments as a percentage of exports or trade balances. Many third-world debtors in recent years have been expected to devote enormous percentages of export earnings to debt-service. Much debt, in fact, was borrowed because of the inability to service earlier debt. Tying payments to the ability to pay seems not only humane, but practical. The London Agreement actually shows how complicated this issue is. The German representatives asked for a firm "escape clause" that would allow them to reduce or stop debt service if they ran into severe trade imbalances. The Allies resisted such a move, and the actual agreement contains somewhat fuzzy language to the effect that (1) Germany could ask for consultations if it ran into transfer difficulties, and (2) that if consulted the Allies would take the transfer issue into account. But this language amounts to considerably less than an "escape clause."

Hersel and other commentators are perhaps understating the subtlety of the negotiations that led to the London Debt Agreement. The German negotiators had two aims: first, to make the debt payments bearable, and second to encourage other countries to create conditions under which Germany could more easily export her goods. A firm escape clause would advance both aims: the Germans would be assured that payments would never exceed some target that was set to reflect her ability to pay, while at the same time the existence of this clause would create political demands in creditor countries to ease Germany's task in resuming her exports. American producers might fear an onslaught of German imports, but American creditors would oppose trade restrictions if such moves would imperil Germany's ability to make payments.

The Allies resisted an escape clause not so much out of fear of German exports as out of fear of what (they thought) they had learned from the 1920s. Any clause that gave Germany the right to stop payments under specific conditions would give rise to moral hazard. There could be conditions under which, for example, the German government would discourage exports to trigger the escape clause, just as some argued the German government had essentially ruined the economy in 1923 to demonstrate that it could not pay the reparations bill.

Odious Debt

The people of some countries today are working to repay international debts incurred by earlier governments that they did not elect or want. Often the debt was used either to provide luxurious lifestyles for a corrupt few, or to pay for the repression of the mass of the population. Yet under the rules of the international financial system, the people of the country are still responsible for the debt or risk loss of access to international credit markets. One case often noted in this context is South Africa. The apartheid regime borrowed money to provide high-quality public services for the white minority, but now the entire country has to repay the debt. The apartheid regime also borrowed money to pay for police and soldiers to keep the majority under control, and now that majority has to, in effect, pay for their earlier repression. This so-called “odious debt” has also become an issue of some debate. Activists argue that a country like South Africa should be able to repudiate the debt without suffering any penalties. Economists such as Kremer and Jayachandran (2002) have considered devising schemes that would deter lenders from lending to odious regimes in the first place.

Were the debts covered by the London Agreement odious, in this sense? Most were clearly not. State and municipal loans from the 1920s were undertaken voluntarily to improve the lives of people in Germany. The Marshall plan and other post-war obligations reflected programs that brought Germany back from the brink of starvation, and rebuilt its economy. But the Dawes and Young loans were viewed by many elements, and not just the Nazis, as “political” debts

arising out of the Treaty of Versailles. Neither the Dawes nor the Young Loans were technically reparations debts, but neither would have been undertaken in the absence of reparations. To say they were politically sensitive or even repugnant is not, however, to say they constitute “odious debt” in the sense of South Africa’s apartheid-era debt. A democratically-elected German government agreed to both the Dawes and Young loans, albeit under considerable pressure.³³

Conclusions

The London Debt Agreement of 1953 established a framework whereby Germany would repay debts on which she had defaulted prior to the war, and repay obligations arising out of post-war assistance from the United States and Britain. The Agreement wrote down the total outstanding debt by about 50 percent and established a repayment schedule that spread payments over 30 years. Germany’s obligations in any one year were fixed so as not to exceed her ability to make transfers abroad. The agreement delayed part of the back interest due on the debt until such time as Germany reunified. With unification in 1990, Germany issued a new set of bonds that when retired will have paid off all the debts from the 1920s, 1930s, and immediate post-World War II era.

Any larger lessons aside, was the Agreement a good one? Germany not only paid off the debts as written down and rescheduled, she did so with considerable ease. The new bonds issued in 1990 were hardly noticed in the overall national balance sheet. Moreover, the Agreement succeeded in building-in an explicit contingency that did not encourage the bad behavior that had made World War I reparations – on their own a bad idea – much worse. The weight of

³³ The issue has risen once again in connection with the 2003 invasion of Iraq. Some observers argue that the people of Iraq should not have to repay the huge debt run up by the regime of Saddam Hussein. In this and in other situations, however, the real motivations may be less enlightened. Some of those advocating debt relief in this case are seeking not to help the people of Iraq, but to punish France and Russia, two of Iraq’s largest creditors. See “Paying for Saddam’s Sins,” *The Economist*, May 17 2003, at p.90. Elsewhere I have argued that the United States should accept the lesson of the London Debt Agreement and make a substantial financial contribution to the cost of Iraqi debt reduction (“Follow the leader on Iraq debt,” *Yale Global Online*, January 13th, 2004.)

scholarship suggests that Keynes' "prophecy" in 1919 was overdrawn. But those who crafted the 1953 Agreement at least understood his fears.

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