THE LONDON SCHOOL OF ECONOMICS AND POLITICAL SCIENCE

Research impact: making a difference

Calling Germany on its hypocrisy in the Eurozone debt crisis

Albrecht Ritschl argued that debt forgiveness to Germany under the Marshall Plan held important lessons for solving the Greek economic crisis

What was the problem?

By 2011 the financial crisis in the Eurozone had pushed smaller economies such as Greece to the brink of bankruptcy. European finance ministers agreed to provide a €110 billion rescue package for Greece to cover the country's borrowing requirements until 2013.

In return, Greece pledged unprecedented budget cuts in the form of cuts in state spending and hikes in taxes, worth €28 billion over four years. This triggered angry protests against Germany, which was seen as the driving force behind these harsh conditions.

Protestors on the streets drew comparisons with the actions of Nazi Germany during the war. Some flew swastika flags and banners comparing Chancellor Angela Merkel with Adolf Hitler. Politicians called for Germany to write off Greece's debts, while others called on Germany to pay Greece compensation for alleged war crimes committed during the Nazi occupation.

What did we do?

LSE Professor of Economic History Albrecht Ritschl conducted research into how Germany was able to pay off its debts after the two World Wars. In particular, his re-interpretation of the scale of financial payments to, and debt forgiveness for, Germany after World War II shed new light on the approach that modern-day Germany should take towards debt-ridden countries such as Greece.

Ritschl looked in detail at the financial assistance that was paid to Germany after the war under the Marshall Plan, in which the US gave $17 billion – around $160 billion in today's values – in economic support to help rebuild European economies. He showed that while the transfers were tiny, the cancellation of debts was worth as much as four times the country's entire economic output in 1950 and laid the foundation for Germany's fast post-war recovery.

This positive impact was reinforced by a decision to reconstitute Germany as an economy led by exports rather than domestic spending, as had been the dominant approach before and during the war. Germany was committed to orthodox fiscal and monetary policies – balancing the budget between revenues and spending and using interest rates to fight inflation. This had the effect of curbing spending by German households and generating persistent trade surpluses, thus putting the country in a strong financial position.

He showed how this strategy was fuelled by a desire of the United States to avoid the mistakes made by the European Allies after World War I. The reparations imposed on Germany under the

Treaty of Versailles, which had required Germany to pay 132 billion gold marks ($33 billion), contributed to a plunge in the German currency and hyperinflation and brought economic misery to German households.

The US intervened to end the crisis and repackage the reparations. It drew up a new reparations plan that staggered the payments and lent Germany 800 million marks. This stabilised the currency but led to the US indirectly funding Germany's reparations to Europe. Released from its financial burden, the German economy then resurged strongly.

However, after the Wall Street Crash of 1929, the US demanded full repayment of its loans to Germany. Ritschl showed that austerity policies imposed on Germany pushed it into the Great Depression and sovereign debt default. The German government cut state spending, wages and unemployment pay. Unemployment rose to 6 million. Ultimately this severe depression paved the way for the rise of the Nazis.

Although debt relief under the Marshall Plan was only intended to be provisional until the reunification of Germany, the debt relief was not in fact cancelled when unification occurred in 1990. According to Ritschl's estimates, Germany's World War II debts nearly equalled its gross domestic product (total amount of economic output) for 1938, the last pre-war year.

In a telling comparison Ritschl showed that the debts racked up by the struggling Eurozone economies – Portugal, Italy, Ireland, Greece and Spain – were equal in size to Germany's current gross domestic product. In other words, debt cancellation for the Eurozone would be equivalent to the debts that were cancelled by the Allies after World War II.

What happened?

Media attention

Ritschl's research took on heightened relevancy and received widespread public interest following the onset of the Eurozone financial crisis. He received particular attention from journalists in Germany, who were interested in findings relevant to Germany's stance on financial bailouts for debt-laden Eurozone countries such as Greece.

An interview on Deutschlandradio Kultur (German radio) in 2011 examined the risks to Greece's society and economy of imposing similar austerity policies to those suffered by Germany in the years preceding Hitler. Ritschl argued that the only way to prevent political

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destabilisation in Greece was a major debt 'haircut' – where creditors have to bear some of the losses by writing off the debts – and the sooner the better.

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Ritschl reiterated his calls for an orderly resolution of Greek debt in an interview with *Frankfurter Allgemeine* in February 2012, which was again widely reported in the European press and led to a spike in media mentions.

Political debate

The Eurozone economic bailout meant that there was a sharp rise in payments from rich member states like Germany to countries receiving the bailouts like Greece. These transfers intensified a debate in Germany over the need to put Greece into insolvency. Ritschl was one of 16 economists to publicly back a call by German Economics Minister Philipp Roesler for a Greek bankruptcy, in opposition to the views of Finance Minister Wolfgang Schaeuble, who insisted that Greece needed to pay its way out of its debt crisis through austerity.

Hans-Werner Sinn, President of the influential Ifo Institute, then wrote an article for the *New York Times* in which he claimed that Greece had already received more financial assistance than Germany had under the Marshall Plan.

Ritschl was asked to respond in *The Economist* and wrote an article in which he said Sinn had failed to include in his calculations large amounts of debt forgiveness for Germany under the Marshall Plan. This led to a heated interchange of responses between Sinn and Ritschl that generated a substantial amount of media coverage.

Three years after Ritschl's research and the disagreement with Sinn, there is little sign that the austerity programme imposed on Greece has succeeded in lifting it out of its debts. In April 2014 Schaeuble ruled out any debt haircuts but said there might need to be a third bailout for Greece.

Research impact: making a difference

Professor Albrecht Ritschl, born in Munich/Germany in 1959, is Professor of Economic History at the London School of Economics. He was previously Professor of Economics at Humboldt University of Berlin, at the University of Zurich, as well as Associate Professor of Economics at Universitat Pompeu Fabra. He has held visiting fellowships at Princeton University and at the University of Pennsylvania. He is a Fellow at the Centre for Economic Policy Research (CEPR), the Centre for Economic Performance (CEP), as well as at CESifo. He is also a member of the Scientific Advisory Board to the German Ministry of Economics. He holds both a doctoral and a habilitation degree from the University of Munich. He has published extensively on German economic history in the 20th century, with a focus on the Great Depression and the 1930s. He received wide press coverage for his warnings against an overly strict approach towards the Greek debt problem. Currently he is speaker of an expert commission researching the history of the German Ministry of Economics and its predecessors since 1919.

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