

How Europe cancelled Germany's debt

The 1953 London Debt Accords show that European leaders know how to resolve a debt crisis

On 27 February 1953, an agreement was signed in London which resulted in the cancellation of half of Germany's (then West Germany's) debt: 15 billion out of a total of 30 billion Deutschmarks.*

Those cancelling the debt included the United States, the UK and France, along with Greece, Spain and Pakistan – countries which are major debtors today. The agreement also included private individuals and companies. In the years following 1953 other countries signed up to cancel German debts, including Egypt, Argentina, Belgian Congo (today the Democratic Republic of Congo), Cambodia, Cameroon, New Guinea, and the Federation of Rhodesia and Nyasaland (today Malawi, Zambia and Zimbabwe).¹



The German delegation signs the London Debt Accords in 1953 (Photo: German Federal Archives)

The German debt came from two periods: before and after World War II. Roughly half of it was from loans Germany had taken out in the 1920s and early 1930s, before the Nazis came to power, which were used to meet payments ordered by the Treaty of Versailles in 1919. They were a legacy of the huge reparations forced on the country after defeat in World War I. The other half of the debt originated from reconstruction following the end of World War II.

By 1952, Germany's foreign-owed debt was around 25% of national income. This is relatively low compared to debtor countries today: Spain, Greece, Ireland and Portugal's debts to foreign lenders are all over 80% of GDP. But West Germany had to undertake huge reconstruction following the war, and foreign currency with which to pay foreign-owed debts was scarce. The German delegation at the conference convincingly

* The debt cancellation was with West Germany, which had inherited all of Germany's debt owed to the western world after World War II. So the cancellation was of 'Germany's' debt, although negotiations were only with West Germany.



Greece's debts have been restructured in the interests of private banks, while repayments have taken highest priority despite five successive years of recession.

argued that its debt payments would rise sharply in the near future, and that this would significantly hinder reconstruction. Following the debt cancellation, West Germany experienced an 'economic miracle' with large-scale reconstruction, and high rates of growth in income and exports. This stability contributed to peace and prosperity in western Europe.

Creditors to West Germany were keen to stabilise the country's politics and economics, so that it could be a 'bulwark against communism'. This unique political reasoning led to creditors adopting a much more enlightened approach to dealing with a country's debt, which has unfortunately not been repeated in debt crises of the last thirty years – in Latin America and Africa (1980s and 1990s), East Asia (mid-1990s),

come out of trade surpluses. If the country had a trade deficit, no payments would need to be made. This meant that it only made debt payments using revenue it had actually earned, rather than having to resort to new borrowing or using up foreign currency reserves. It prevented a return to crisis or long stagnation. If it did have a trade deficit, West Germany was also allowed to restrict imports.

For creditor countries it meant that if they wanted to be repaid, they had to buy West German exports. The mechanism for doing this was that they allowed their currencies to 'rise' against the Deutschmark. This meant it was cheaper for their citizens to buy products produced in Germany. This increased German exports, earning the country the money to repay the remaining

Russia and Argentina (turn of the millennium) and Europe today. Through these crises, Germany has been a creditor, as can be seen most starkly in the current European debt crisis.

As well as the scale of debt cancellation, there were several other features of the London Debt Accords which were of great benefit to Germany, and the principles of which could be applied to debtor countries today.

1) Setting limits on debt payments

Most ingeniously, it was agreed that West Germany's debt payments could only

Deficits, surpluses and debt

If a country is exporting more than it is importing, it has a trade surplus. This means it has left over revenue which is not spent on any imports. It either has to be spent on paying debts, or has to be lent to other countries, creating debt for them.

If a country has a trade deficit, it is importing more than it is exporting. To be able to do this it either has to borrow money from other countries, or sell assets it owns to other countries.

Debts between countries are therefore caused by (or cause) trade deficits and surpluses. If one country wants to have a surplus, it relies on another country

having a deficit. The more countries are in balance with each other, the more stable the world economy will be.

In order for debts to be repaid, debtor countries need to have trade surpluses, and countries which are owed money need to have trade deficits. It is very difficult for debtor countries to move to having a trade surplus, if creditors are not willing to also move to having deficits.

It is not theoretically possible for all countries to have surpluses, short of the Earth trading with another planet.

debt. This effectively meant that creditors had to restructure their economies as well – by importing (ie. consuming more) rather than forcing the debtor to implement austerity.

West Germany did indeed have trade surpluses throughout the period of debt payment, and so the clause never needed to be invoked. But its presence helped rebuild the West German economy and export base by giving an incentive for creditors to buy West German exports, and allow the Deutschmark to devalue against their currencies.

However, German competitiveness and undervaluation of the Deutschmark continued following the period of debt repayment, and was ‘locked-in’ with other Eurozone countries with the creation of the Euro in the 1990s. Whilst in the 1950s and 1960s West Germany’s trade surpluses enabled the debt to be paid, in more recent decades they have contributed to increased debt in other countries, most notably countries such as Greece, Ireland, Spain and Portugal today.

Given the debt cancellation, and reduction of interest rates, West Germany’s relative debt payments were 2.9% of exports in 1958, the first year for repayments, and then fell as exports grew. In contrast, today the IMF and World Bank regard debt payments of up to 15-25% of export revenues as being ‘sustainable’ for the most impoverished countries.

In 2015, Germany is expected by the IMF to yet again have a trade surplus, of 5.8 per cent of GDP, when it could be buying exports from debtor countries to help get them out of the crisis. Moreover, debt payments are far higher as a percentage of exports than the maximum spent by West Germany following debt cancellation. The Greek government’s foreign debt payments are around 30 per cent of exports.²

Heavily indebted countries in the global South are also making debt payments at much higher levels than West Germany did. Pakistan, the Philippines, El Salvador and Jamaica are all spending between 10 and 20% of export revenues on government foreign debt payments.³ This does not include debt payments by the private sector.

2) Including all types of creditor

All types of creditor were brought into the restructuring, whether foreign governments or companies. This ensured equal treatment for all, whilst preventing Germany being pursued by companies for double the amount of debt it was paying to others.

This is in marked contrast to debt restructurings of recent years. The Heavily Indebted Poor Countries initiative, which cancelled \$130 billion for 35 of the most impoverished countries in the 2000s, only cancelled debts owed to international institutions



'Zombie bank' Anglo Irish had its debts taken on by the Irish government.

and foreign governments. Private companies were not compelled to take part. This has led to some of the poorest countries in the world, such as Sierra Leone, Zambia and the Democratic Republic of Congo, being sued in western courts by vulture funds, for huge amounts on debts which they paid very little for.

In late 2001, Argentina defaulted on its debt when it became simply too large to pay. Many of the private creditors agreed to sign up to new agreements where they would be paid 30 cents in every dollar that was owed. However, some holdout creditors, many of them vulture funds who bought the debt cheaply in the midst of the crisis, are suing the now-solvent Argentina for the full value of their debt.

In June 2014, the US Supreme Court upheld a New York court judgement in favour of two US vulture funds, NML Capital and Aurelius Capital, who are seeking \$1.3 billion from Argentinian debts dating back to the 2001 crisis. The judgement made it illegal for Argentina to pay any of its debts unless it agreed to pay the vulture funds in full. Argentina refused, forcing it into a new debt default and a stand-off which continues today.

In Greece, two debt restructurings were held in 2011, which resulted in over 90% of private creditors taking a more than 50% reduction in the debt owed to them. This ‘reduction’ was still more than the private holders of the debt would have got if they had sold the debt on the market. And creditors insisted that the new debt was issued under foreign, mainly British law, giving the

Greek government much less control over its debt in the future.

Furthermore, creditors who held the old debt under non-Greek law, such as in the UK or Switzerland, were able to stay out of this deal, and are still being paid the full amount, more than double what other creditors are receiving. Again, many of these are vulture funds who bought the debt cheaply and so are making a huge profit out of the Greek people. Moreover, bailouts over the previous couple of years mean much of the Greek debt has been transferred away from being owed to banks and to public institutions such as the IMF and EU governments instead. This debt was exempted from any reduction, and so Greece's foreign-owed debt is now well over 100% of GDP.

3) Including all debts owed, not just government

The London Debt Accords addressed all debts owed by the West German economy to people, governments and companies in other countries. It therefore included debts of German individuals and companies, not just those of the government.

Much of the debt crisis today has been caused by debts owed, at least initially, by private companies, especially banks. For example, borrowing by Ireland's private sector led to the foreign debt of the country as a whole reaching 1,000% of GDP by 2007. In contrast to the reckless lending and borrowing of the private sector, the government had a budget surplus during this time, and its total net debt – owed to both Irish savers and foreigners was down to just 11% of GDP by 2007.

For an economy to escape from the stagnation caused by debt, the debts owed by both governments and private companies need to be addressed.

4) Negotiations rather than sanctions

If West Germany did not, or was unable, to meet debt repayments, the agreement said there would be consultations between the debtor and creditors, whilst seeking the advice of an appropriate international organisation. This is in marked contrast to debt 'negotiations' over recent years where creditor

governments and institutions, such as the Paris Club, IMF and European Central Bank, have dictated terms to debtor countries, and forced them to implement austerity and free market economic conditions. As it transpired, West Germany did not have further problems with the debt, so again the clause never had to be invoked.

Greece: Break the chains

Inspired by the ancient idea of jubilee, a time when debts were cancelled, slaves were freed and land was redistributed, Jubilee Debt Campaign is calling for a new debt jubilee in response to today's global economic crisis. Such a jubilee would provide a framework for tackling today's debt and banking crisis in Europe, as well as the continuing burden of unjust debt in the global South. It would mean:

- Cancelling the unjust debts of the most indebted nations
- Promoting just and progressive taxation rather than excessive borrowing
- Stopping harmful lending which forces countries into debt

Greece is clearly one of the countries most in need of debt cancellation today. After more than four years of austerity, Greece's debt has risen from 133% of GDP to 174% of GDP. The minimum wage has fallen by 25%, and youth unemployment is over 50%. Plus more than 20% of the 11 million people in Greece are now living below the poverty line. It is vital that Greece's creditors learn the lessons of Germany's debt deal of 1953 and break the chains of debt for Greece today.

► **TAKE ACTION:** Support our call to break the chains of Greece's debt at: www.jubileedebt.org.uk/greece

► **READ MORE:** Read our Six key points about Greece's debt briefing at: www.jubileedebt.org.uk/6pointsgreece

REFERENCES

1. This, and much of the information in this briefing on the German debt cancellation deal, comes from: Kaiser, J. (2003). *Debts are not destiny! On the fiftieth anniversary of the London Debt Agreement*. Erlassjahr.de (Jubilee Germany). And two other Erlassjahr.de documents 'Double standards applied' and 'Q&A about the London Debt Accord for Germany 1953'.
2. IMF, World Economic Outlook database.
3. World Bank, World Development Indicators database.



Jubilee Debt Campaign is part of a global movement demanding freedom from the slavery of unjust debts and a new financial system that puts people first.

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