A destitute family in Fleet Street, London, in November 1919. The victory effort left Britain's economy weakened and the government unable to meet the needs of its war-weary citizens

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> 'Britain had borrowed heavily from the US, and lent nearly as much to Russia, which defaulted on all its debts'

FINANCIAL

Europe's unsettled debt

by Mark Harrison

In the First World War, British soldiers sang (to the tune of a well-loved hymn): *"When this lousy war is over / No more soldiering for me / I will get my civvy clothes on / Oh, how happy I shall be!"* But the postwar world was not the promised land the soldiers longed for. While almost everyone dreamed of peace and normality, the war left too many unhealed wounds and unsettled debts.

The First World War spilled blood and squandered resources on a colossal scale. For several years, the European powers put one-third to one-half of their national incomes into the fighting.

When the fighting stopped, the survivors hoped for a return to peacetime prosperity. Europe's economies began to grow again, but from lower bases than before. France and Britain recovered their prewar positions within a few years, as did the neutral countries. In central and eastern Europe the violence took longer to die away; it took roughly a decade to restore prewar incomes.

In fact, nothing was quite the same. Everyone now had to face large unsettled debts, but their efforts were complicated by a great dislocation of the international order.

The Austro-Hungarian, Russian and Ottoman empires were dissolved. This created more than a dozen states with fragile constitutions and untried, ambitious elites. New states formed new, disputed borders, which created fresh barriers to trade, lending and migration. New governments bought short-term popularity by spending without taxing, causing inflationary crises.

Every country had borrowed heavily to pay for the war: borrowed from wealthy elites, from working families and from Britain and France, which in turn borrowed from the US. New debts were created by postwar treaties, which further obligated the defeated countries to the victors. The public debts of Britain and France stood at two or three years of national income. In these countries, debts pushed governments to prioritise fiscal austerity over short-term giveaways. They could not meet the expectations of their war-weary people.

Europe had two special cases: Germany and Russia. Shattered by war and revolution, Russia's political order was replaced by a communist dictatorship that repudiated debts, sealed its people from the west, and eventually turned to developing industrial and military power at all costs.

Germany was punished under the Treaty of Versailles by annexations, and burdened by Allied demands for war compensation that its political class had no will to pay. Soon after the war, these two isolated powers, Germany and Russia, moved towards secret military and economic collaboration.

Unrest and isolationism

Across the oceans, the war mobilisation of the old industrial powers had created a global shortage of manufactured goods. Newly industrialising economies from Japan to Argentina had rushed into the gap. Like a gold rush, the opportunity was short-lived; the end of the war threatened these new players with a return to business as usual.

The British economy was weakened by the war. It had borrowed heavily from the US, and lent nearly as much to Russia, which now defaulted on all its debts. At home, the question of who should pay stimulated social conflict, while in the colonies independence movements grew.

The US, the world's strongest economy in finance and productivity, had bankrolled its own war effort and partly that of the Allies. But it now turned away from Europe under the banner of isolationism.

The unsettled debts of the First World War did not make the Second World War inevitable. A few decades of prosperity were needed to pay off the debts or forgive them without causing friction. This seemed possible until the Wall Street Crash in 1929 – after that, the chances of avoiding another, still greater conflict dwindled.

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