ECONOMICS AND THE EUROPEAN UNION Part One - Germany before 1945
Article by Peter Brooke, taken from http://www.peterbrooke.org/politics-and-theology/eu-economics/
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'Executive summary'

This article is intended as the first in a series on European economic history prompted by my interest in what is called 'Modern Money Theory' (MMT) - briefly, the view that, since the state is the source of money, a government that has full control over its own currency can never run out of money. It can always afford to buy whatever is for sale in its own currency without recourse either to taxation or borrowing. If there is competition between government and non-government spending for scarce resources, money creation may well result in inflation, but the problem lies with the lack of resources not with money creation as such.

MMT has developed as a sophisticated body of economic thought - mainly in the US in the Levy Institute by disciples of the economist Hyman Minsky - since the apparently now definitive collapse of the gold standard in 1971. Previously, even when countries for one reason or another went off the gold standard - ie ceased to peg their currency to the value of gold - gold was still seen as the guarantor of what might be called the reality of money, especially important in transactions across national borders. There were, however, three occasions prior to the Second World War when Germany, while maintaining its gold based mark/reichsmark, developed what amounted to parallel currencies that were not based on gold and could not be used for international transactions - the 'Darlehnkassenschein' (loan-bank bill), which helped to finance the First World War; the 'rentenmark', which helped resolve the problem of the hyperinflation of 1923; and the 'mefa bill', which helped with the restoration of the German economy and rearmament in the 1930s.

Although on all three occasions the German government insisted on its adherence to the existing liberal orthodoxy in money matters, the period also saw, in the writings of the German economists Georg Friedrich Knapp and Friedrich Bendixen, the development of 'chartalism' - the theory of money as a creation of the state, the precursor of today's MMT. This development was followed with interest in Britain by J.M.Keynes. He was concerned with the problem of financing not just the British but the whole anti-German war effort of different countries in 1914-18. Unlike the Germans, however, Britain had the advantage of access to money and manufactured goods from the United States. Gold in his hands became not so much a guarantor of the value of sterling as collateral for the supply of material and money from the US. Gold was there, he said, to be used*. As a result of the steadily increasing reliance on support from the US, however, the First World War marks the moment when the dollar replaced sterling as the dominant international currency.*

JOSEPH HALEVI AND MICHAL KALECKI

I want to give an account of the post-war history of Europe, borrowing heavily from three articles by Joseph Halevi published last year by the New York based Institute for New Economic Thinking (INET) on 'The political economy of Europe since 1945'.[1] Halevi calls this a 'Kaleckian perspective' and perhaps I should start with some remarks on Halevi and on Michal Kalecki.

Halevi was born in Haifa in 1946. Although Jewish, he describes his earliest intellectual mentors as having been 'Tawfiq Toubi and Emile Habibi, whom I knew personally: both were leaders and MPs of the Communist Party of Israel and major intellectuals of the Palestinians in Israel.' In the late sixties, he moved to Italy where, on the recommendation of the Italian Communist Party, he worked for the General Confederation of Labour. It was only reluctantly that he became an economist but his reluctance turned to enthusiasm when he overcame his initial Communist-inspired prejudice against Keynes. His academic career was pursued in Italy (Rome and Turin), the US (New York), France (Grenoble) and Australia (Sydney).

Asked if he was still a Communist, Halevi replied: 'Yes, I am. Although this requires rephrasing after all that has happened, but the idea of overcoming capitalism and establishing a system of socialised means of production are two important principles I still endorse.' He says of Kalecki that he 'is really what today's classical economics should be had it been allowed to develop freely, not in some niche tucked away God knows where. He brought together business cycles with the issue of effective demand, linked the latter to the issue of market power and conditions of production. He was an absolute genius. He also formulated the modern theory of socialist planning.'[2]

Kalecki was Polish, born in 1899. At the age of thirty he worked for the Warsaw based Institute of Research on Business Cycles and Prices, and in 1933 he wrote 'An Attempt at the theory of the Business Cycle', offering a 'macroeconomic theory of effective demand' three years before Keynes's 'General Theory'. He resigned from the Institute in 1936, protesting against political interference. The same year, after reading Keynes's General Theory, he went to Cambridge, becoming particularly friends with Joan Robinson. Robinson believed that he had anticipated Keynes who, however, kept his distance. In his 1939 article 'Political aspects of full employment', he argued that Keynesian methods could achieve full employment but this would lead to a more assertive working class which in turn would lead alarmed business leaders to abandon the policy. This was part of his theory of the political - as opposed to merely technical economic - business cycle.

In 1955, after a spell in New York as Deputy Director in the Department of Economic Affairs of the UN Secretariat, he returned to Poland and in 1957 was appointed chairman of the Central Commission for Perspective Planning. His advice, however, largely directed against over ambitious targets, was disregarded. He resigned in 1968, shortly before his death in 1970, in

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[1] Joseph Halevi: *The Political Economy of Europe since 1945 - A Kaleckian perspective**, INET Working Paper No. 100, June 2019 (http://doi.org/10.36687/inetwp100); idem: *Europe 1957 to 1979: From the Common Market to the European Monetary System,* INET Working Paper No. 101, June 2019 (http://doi.org/10.36687/inetwp101); idem: *From the EMS to the EMU and…to China,* INET Working Paper No. 102, September, 2019 (http://doi.org/10.36687/inetwp102)

[2] Interview by Judie Cross. March 6, 2018, http://figureground.org/interview-joseph-halevi/

despair because of the perceived persecution of Jewish colleagues in the anti-Zionist campaign that followed the Israeli victory of 1967. Kalecki was Jewish but hadn't himself been targeted.[3]

It's difficult for me as a non-economist - and most certainly non-mathematician - to give an account of why he was important but he seems to have had a more political, class struggle orientated vision than Keynes. He dealt with longer time frames and his theory of the 'political business cycle' took into account likely political developments, for example, as we have seen, the consequences of the increase in working class/trade union power that would result from Keynesian policies promoting full employment.

Halevi introduces him to the discussion by referring to a paper he wrote in 1932 - 'The Influence of cartelisation on the business cycle.' The theory of 'cartelisation' had been developed within Marxism by Rudolf Hilferding in his book *Das finanzkapital* (1910). The advantage of the cartel is that it can determine its prices independent of considerations of competition. It can decide freely on what it wants by way of profit above expenses. Hilferding argued that this helped to stabilise a nationalist capitalist economy. Kalecki on the other hand argued that it was destabilising because it enabled the cartel to maintain a productive capacity beyond what a national economy could absorb. 'Cartels compete not through prices but via the building up of productive capacity so that during a boom they engage in an investment race leading to excess capacity, thus contributing to the demise of the boom itself.'[4] The cartel then reduces output and lays workers off and that hits the demand for consumer goods which are still being produced by industries subject to the rigours of competition. Thus Kalecki argued that, contrary to Hilferding's thesis, a heavily cartelised economy was less stable - more prone to booms and busts - than a more purely competitive system.

Germany prior to the First World War had been a heavily cartelised economy and this was part of the problem after the war. Like the USA in the 1930s depression, a huge productive capacity faced a very limited market. As a result of the war Germany had lost much of its access to its Eastern hinterland, both as a market outlet and as a source of of raw materials. Although Halevi's articles concern the period after the Second World War I'd like to begin by discussing this earlier period - the period in which the body of thought we call 'Keynesian' was developed - beginning with some thoughts (mainly my own, not Halevi's) on the hyperinflation in Germany.

GERMANY AFTER THE FIRST WORLD WAR - THE RENTENMARK

This is often presented as a consequence of excessive money printing but it would be more accurate to say that the excessive money printing was a desperate attempt to catch up with the fall in the value of the existing German currency, the paper mark. But what did it mean to say that the value of the mark was falling? It was falling in relation to the internationally agreed value

[3] See e.g. A. Asimakopulos: 'Kalecki and Robinson: An "Outsider's" Influence', *Journal of Post Keynesian Economics*, Vol. 11, No. 2 (Winter, 1988-1989), pp. 261-278 and Andrzej Brzeski: 'Kalecki and the Polish Economy' review of 'The Intellectual Capital of Michal Kalecki, A Study in Economic Theory and Policy' by George R. Feiwel, *Soviet Studies*, Vol. 28, No. 4 (Oct., 1976), pp. 616-620.

[4] Halevi: Europe since 1945, p.3

of gold. The importance of gold was that it established what could be described as an internationally acceptable currency, a fixed criterion by which the value of the different national currencies could be measured. The problem for Germany was that it was heavily reliant on imports both for food and for raw materials for its large scale industry. According to the account by Richard Overy: 'the territories lost to Poland and France contained three-quarters of Germany's iron ore and one third of her coal; 90 per cent of the German merchant fleet was confiscated; all Germany's overseas assets, totalling 16 billion marks, were forfeited.'[5] It had a heavy debt burden from the loans issued to finance the war. It had to pay heavy reparations and the problem was exacerbated when, owing to the difficulty of paying the reparations, its most productive remaining territory, the Ruhr valley was occupied by the French and the German government pursued a policy of subsidising the local population to refuse co-operation with the occupier.

An account is given in an article published in 1927 by Edgar Vincent, then Baron d'Abernon of Esher, who was British Ambassador to Berlin from 1920-25:

'The Reparation Commission fixed the sum at 132 thousand millions of gold marks (£6,600 millions). An interallied conference met in London in May, 1921, and determined the schedule of payments that the German Government had to meet. An important provision of the so-called" London Ultimatum" laid down that Germany must pay a sum in cash of 1 thousand millions of gold marks ($50 millions) before the end of August, 1921. That payment was duly met, but the German Government had to borrow about two-thirds from the firm of Mendelssohn and Company, repayable before the end of the year. This operation is likewise reflected in the exchange rates ...[6]

A table showing the exchange rate of the paper mark to sterling shows the figure rising from 247 marks to the pound in May to 1,041 in November, falling again to 794 in December.

'The year 1922 was fated to lead to disaster. The Committee of Guarantees, set up under the authority of the London Conference, instituted a-system of ten-day cash payments, each of 3I millions of gold marks (£I,550,000 - [this was the mark as it would be if struck in gold specie - PB]*). This system was continued under the decisions of the Cannes Conference (January, 1922) until it became impossible to find the money. By the middle of May the German Government had asked for a moratorium ...'*

The exchange rate now rose from 811 in January to 34,858 in December.

'During 1923 the Ruhr territory was occupied by Franco-Belgian troops; a foreign administration seized the Customs and levied other imposts. Not only was a valuable economic area separated administratively from Germany, but important revenues were destroyed or diverted to foreign treasuries - destruction occurring to a larger extent than diversion. At the same time, the

[5] R.J.Overy: *The Nazi economic recovery, 1932-1938*, Cambridge University Press, 1996 (first published 1982), p.6

[6] [Edgar Vincent, Baron d'Abernon of Esher]: 'German Currency: Its Collapse and Recovery, 1920-26' *Journal of the Royal Statistical Society*, 1927, Vol. 90, No. 1 (1927), p.9.

Reich - to support passive resistance - elected to make colossal payments in aid of its citizens in the Ruhr, with disastrous effect on the budget and the mark exchange.'

83,190 in January to I8,349,000,000,000 in December.

D'Abernon subscribes to the printing money argument, saying that the government was resorting to the printing press instead of taxation to make up its budget deficit. But where was the taxation money to come from when the major industries, deprived of access to raw materials, access to markets, access to investment finance, couldn't function, with the inevitable catastrophic consequences for the smaller domestic consumer industries. In fact the collapse in the value of the mark was a collapse in its value on the foreign exchange market, its ability to pay for imports. The German citizen holding, say, 4,000,000 marks was in much the same position as he would have been a couple of years earlier holding 4 marks, except that he had to get rid of it quickly before it fell yet further in value. The problem was a problem of 'velocity' - the speed at which the money no-one wanted was circulating. No-one was going to want to save, no-one wanted to possess large quantities of it. In the end it was, as d'Abernon's own account shows, largely *solved* by printing money - by creating a new currency, independent of gold, and, though d'Abernon doesn't stress this, of the foreign exchange market - the 'rentenmark.'

D'Abernon stresses the problem of the depletion of Germany's gold reserves, first to pay for reparations as confidence in the paper currency was destroyed, then to pay for the resistance in the Ruhr:

'*The great characteristic of this period was the depletion of the Reichsbank gold reserves and foreign bills portfolio ... during eleven months the gold reserve diminished by a sum of 538 millions of gold marks (£26,900,000), but it would be incorrect to suppose that all this gold was used to intervene in support of the mark. There were other pressing claims that had to be met ... Four Treasury bills for the account of the Belgian Government, duly endorsed by the Reichsbank, were paid out of the gold reserve* [March to June 1923. This was the method adopted at the time for payment of reparations - PB] *... Of the remaining 33I.4 millions of gold marks, part of that sum - it is impossible to indicate the exact amount, but it is estimated at one-third - was used to meet Government imports necessary to maintain the spirit of passive resistance in the Ruhr, e.g. imports of food and of British coal for the railways.*

'The occupation of the Ruhr played havoc with Germany's power to export, and consequently jeopardized that share of export bills of exchange that accrued to the Reich under the system of export control that had been set up (so-called "Aussenhandelsstellen"*). These foreign bills formed the normal source from which the* "Devisenbeschaffungsstelle" *met the Government imports of foods, fats, and such-like necessaries ...*

'By the end of the first week of September the exchange had reached 240 millions of paper marks for £1. A new crisis had intervened, and it was then resolved to resort to extreme measures and to seize foreign currencies wherever they were to be found. To this end Dr. Fellinger was appointed "Devisenkommissar" *with plenary powers, three paragraphs of the Reich's constitution being suspended to allow him full scope. People's houses and cafes were searched, letters opened, bill-brokers' transactions scrutinised, while bills of exchange accruing*

from exports were now centralised in the Commissioner's hands. It is estimated that these drastic measures produced about 100 millions of gold marks (£5 millions)'

Eventually:

'On September 26, 1923, Dr. Stresemann took the plunge by announcing the complete abandonment of the policy of passive resistance; it was admitted that it was doing more harm to Germany than to France. In the beginning of October he attempted another step, viz. the adoption of an "Enabling Act" (Ermachtigungsgesetz)*, giving extensive extra-constitutional powers to the Government, for he perceived that nothing less than a virtual dictatorship was now necessary to meet the situation. The Socialists resigned from the Ministry, and Dr. Stresemann, again being called upon to form a Government, invited this time to the Finance Ministry Dr. Luther, who proved to be the man of the hour. Under threat of dissolution, Dr. Stresemann forced the Reichstag to pass the "Enabling Act," which was to herald a new era.'*

The rentenmark was the development of a solution originally proposed by Karl Helfferich formerly Minister of Finance then Minister of the Interior and Vice-Chancellor during the war and now a leading member of the monarchist and anti-semitic (Jews could not join it) German National Peoples Party. His proposal was that a new currency be issued based not on gold but on rye - the Roggenmark, rye-mark (people were already shifting to local unofficial currencies including one based on rye[7]). Helfferich's proposal was taken up, against the opinion of most of his economic advisers, including Hjalmar Schacht, by the Minister of Finance, Hans Luther, Hilferding's successor and later, under Hitler, ambassador to Washington. But instead of rye, 'with a rare and an admirable understanding of the metaphysical elements, Dr Luther chose the term "rentenmark" whose basis, consisting of a lien on German agriculture and industry, inspired the public with adequate confidence' (d'Abernon, p.24).

By 'metaphysical' d'Abernon really means 'psychological'. The rentenmark could be described as a confidence trick (if we don't already believe that the gold standard is itself a confidence trick. What matters is not any intrinsic value money might have but the confidence people have in it). The Rentenbank, which issued the new currency 'acquired on all agricultural properties a mortgage, expressed in gold, of 4 per cent. of the value of the property as assessed for the purpose of the Imperial Defence Levy (*Wehrbeitrag*) of 1913. The mortgages bore interest at 6 per cent, payable in Rentenmarks according to their gold value at the time of payment. On all industrial, commercial, trade, banking and transport undertakings, bonds in favour of the Rentenbank were made out to the same gold-mark amount as the total mortgage burden placed on agriculture, such bonds bearing interest at 6 per cent.'

Its value was determined by the simple device of striking twelve noughts off the value of the mark which on November 20th had reached one billionth (taking a billion in the old English

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[7] 'the Rye-Annuities Bank, founded in August 1922, issued annuity bonds on a rye-value basis. In addition, other obligations were issued based on various material values (i.e. coal, potash). Only in June 1923, when the purchasing power of the mark had already sunk to less than a ten-thousandth of its previous value, was the law on stable-value mortgages promulgated. It permitted borrowing through mortgages based on rye, wheat or fine gold; "fine gold"' was at the time in fact a synonym for the dollar.' Otto Pfleiderer: 'Two Types of Inflation, Two Types of Currency Reform: The German Currency Miracles of 1923 and 1948' *Zeitschrift für die gesamte Staatswissenschaft / Journal of Institutional and Theoretical Economics*, September 1979, p.354.

sense of a million million) of its pre-war value (the old paper marks continued in circulation, exchangeable with the new currency at a rate of a billion to one).

As d'Abernon says: 'The real value of the mortgage guarantee was doubtful' and later he says 'Confidence was created mainly through restriction [a legal limit was placed on the amount of notes that could be issued - PB], assisted by a more or less illusory mortgage.' It was not redeemable in gold. Nor (and d'Abernon only remarks on this in passing but it seems to me to be of crucial importance) could it be used internationally: 'the rentenmark was never made legal tender (though it was accepted up to any amount in payment of taxes etc), this quality being alone held by the paper mark which for the purposes of foreign exchange remained the sole official currency.' In August 1924, the paper mark was reissued as the gold-based 'reichsmark', now with the same one for one value as the rentenmark. This was the achievement of Hjalmar Schacht, Reich currency commissioner and soon to be President of the Reichsbank. According to the Wikipedia entry 'The Rentenbank continued to exist after 1924 and the notes and coins continued to circulate. The last Rentenmark notes were valid until 1948.'

To summarise. For all the confidence building theatre about agricultural and industrial mortgages, the rentenmark was a pure fiat, non-gold based currency and as such could not be used outside the frontiers of the domestic economy. The paper mark was used internationally and therefore its value in relation to gold - as the internationally recognised standard of value - mattered. The cause of hyper-inflation wasn't money printing - that was an apparently inescapable consequence - it was the collapse of the productive capacity of the nation, whose major industries were deprived of access to the necessary raw materials. An export driven economy that couldn't export and an import dependent economy that couldn't import, with no quarter being given in the demand for reparations.

The main virtue of the rentenmark was to slow down the velocity of money, providing the domestic market with a currency people were willing to hold in their pockets for longer than a couple of hours, and this tided the economy over until late 1924, when the reichsmark could be introduced as a stable currency that could be used both domestically and internationally. The rentenbanks however continued to exist and to issue money - even as late as 1937, with the rentenmark accepted a a domestic currency until 1948 (Wikipedia).

The introduction of the reichsmark had been made possible by the new arrangements for reparations agreed in August 1924 under the Dawes Plan which set up a sort of circular arrangement in which the money being sent to the US from the wartime allied countries in payment of war debts then came to Germany in the form of intensive capital investment which, in theory at least, enabled the Germans to develop a balance of payments surplus, enabling them to pay reparations to the wartime allied countries.

The arrangement was not quite as favourable to Germany as that might appear. According to Richard Overy:

'After the inflation, German interest rates remained at what were then perceived to be exceptionally high levels. The high cost of money reflected a shortage of savings following the inflation, and an understandable reluctance to run risks on the part of German investors.

Although capital shortages were made good to some extent by large imports of money from abroad, the investment ratio in the 1920s remained well below the pre-war level, while smaller industrial producers, artisans and peasant farmers were left short of capital or were forced to pay for funds at usurious rates. Since craftsmen and peasants made up well over one-third of the working population, the problems they faced acted as a serious drag on the overall performance of the economy ... Public spending provided some cushion against the slow growth of demand and rising unemployment. In 1928 public authorities were responsible for 47 per cent of all building work in Germany. Road-building, electrification and the development of municipal services all helped to maintain business activity and stimulate demand as they were to do later under the Nazi regime, but they did so at the price of drawing in large foreign loans during the 1925-9 period that left the German economy very vulnerable to shifts in the world economy.' (pp.7-8)

The element that was strengthened by this foreign investment was, then, the cartel - large scale, specialised industry relatively free of the rigours of competition - as opposed to the smaller scale competition based agriculture, crafts and shopkeeping.

DURING THE FIRST WORLD WAR - THE *DARLEHNKASSENSCHEINE*

The rentenmark was not the first or the last time what was effectively a pure fiat currency that could not be used internationally was introduced in Germany. Karl Helfferich has been given credit for developing the principle on which the rentenmark was based, but those who see the problem in terms of money printing and government deficits also blame him for the hyperinflation in the first place, seeing it as the culmination of a process that began in 1914 but was greatly exacerbated in 1916. Helfferich was, as we've seen, Minister of Finance in 1915 and then Vice Chancellor in 1916. The criticism made of him was that he financed the war through government debt rather than through taxation. This was particularly the case after Autumn 1916 when the 'Hindenburg plan' required a vastly increased expenditure on armaments.

Helfferich was, or purported to be, a strong believer in gold as the guarantor of the value of a currency and at the start of the war, when convertibility was suspended (people could no longer demand gold in exchange for paper notes) the principle was laid down that the Reichsbank could not issue paper money to a value of more than three times its holding in gold reserves, meaning that 'the only fetter restraining the Reichsbank from printing unlimited paper currency was the amount of gold, or gold-equivalent reserves held in its vaults.'[8] For this reason the German government launched a drive to collect as much gold as it possibly could, persuading the public, with great success, to give up its gold coinage in exchange for paper money. As a result, Germany emerged from the war with very substantial gold reserves which it rapidly lost in

[8] Stephen Gross: 'Confidence and gold: German war finance, 1914-1918, *Central European History*, June 2009, Vol 42, No 2, p.228. It should be said that this proportion of paper money to gold holdings had been established in 1875 (according to d'Abernon, 1876 according to Gross). Gross teaches in the Center for European and Mediterranean Studies and the Department of History at New York University with a specialist interest in the German economy throughout the twentieth century. He has a website - http://www.stephengross.org/.

the circumstances of the reparations, occupation of the Ruhr and hyperinflation of the early 1920s.

Helfferich had published a book on the merits of gold in 1903. In 1905, Georg Friedrich Knapp published his *State Theory of Money*, laying out the case for what was called 'Chartalism', which subsequently became Abba Lerner's 'Functional Finance' and is now making progress as 'Modern Money Theory.'

In his account of German finances during the war, Stephen Gross says:

'German economic commentators were roughly divided in their theories of money into two camps: bullionists and nominalists. The former believed that the value of paper money depended on its connection to the commodity of gold, whereas the latter were disciples of Georg Friedrich Knapp, who argued in 1905 "that money was not a commodity, but rather a purely functional instrument created by the state." In his speeches to the Reichstag, Helfferich was a bullionist, and with a few exceptions, many economists writing about war finance echoed his broad interpretation of money.' (p.240)

He quotes an economist of the time, Franz Eulenberg, as saying:

'With one blow ample quantities of cash have been created, indeed, cash that is sufficiently covered .... All of the gold flowing into the Reichsbank serves to increase the quantity of circulating money and to strengthen the coverage of printed notes. It is necessary that we unflinchingly adhere to the one-third coverage. Only then will our banknotes truly have their full worth: when this gold reserve forms the basis of them.'

The nominalists thought the gold ratio was absurd but nonetheless supported it as a means of getting the public used to using paper money. Gross takes the example of Werner Sombart, sociologist-economist and disciple of Max Weber, author of an influential study of the role of Jews in the development of capitalism:

'Writing a series of articles for the Berliner Tageblatt *in August 1914, Sombart reassured readers that fear of an Assignat-like inflation*[9] *was a "misconception" and even in a military defeat "paper money would retain its full worth." Although Sombart forcefully argued that the public should accept Reichsbank notes because the state had ordained them a "legal means of payment," he reassured those "gold fetishists" that Germany's paper money still rested on a golden basis. "The foundation of our bank laws remain unchanged: each note must be covered by one third of hard currency and two-thirds through good bills with at least two signatures."'*

A more sceptical view was expressed by Friedrich Bendixen:

'Friedrich Bendixen stands out as one of the few German critics who understood the arbitrary nature of the gold ratio. As a disciple of Knapp, Bendixen's stance toward the Reich's finances was complex. For while most other economists praised the Reichsbank for its actions in August, Bendixen remained unimpressed because he had suggested this move to a fiat system - proclaiming credit guarantees for private banks and eliminating gold convertibility - be taken in

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[9] The 'assignat' was a paper currency introduced in the French Revolution which very rapidly lost its value.

1908. To the extent that the one-third gold ratio was predictable it could be a stabilizing element in the economy. Beyond this, though, he saw the ratio concept as more of a cult:

"'Today, one considers it as a law of nature, that for every golden twenty-mark piece, three paper twenty-mark pieces can be put into circulation. Naturally that is completely false. But for the public the proposition that gold metamorphises into three times its worth in paper works like a graceful wonder, and gold flows into the Reichsbank in an ever unbroken stream. So this absurdity generates a highly desirable result [that paper money is used and accepted by the public]."

'Ultimately he hoped that the Reichsbank would avoid falling victim to what he deemed to be a popular belief. Thus, while Bendixen aspired to a purely fiat system of paper currency, the transitional stage of a currency based on the symbol of gold instead of the abstract strength of the state had no place in his logic. Over-reliance on gold could be dangerous, and perhaps on account of this belief and his outspoken criticism of the Reichsbank, the Reich censored him, his book reaching publication only in 1919. The confidence of the people in Havenstein [President of the Reichsbank - PB] *had to be spared.'* (pp.241-2)

However, even at the beginning of the war, the two thirds rule was breached by the introduction of another, supplementary currency that was not tied to gold and could not be used internationally. This was the 'Darlehnkassenschein' - loan-bank bill - and it acquired particular importance with the Hindenburg programme of 1916 playing what Gross calls an 'infamous role in helping the Reich circumvent the gold ratio: printing more money while maintaining the illusion that this money was backed by gold.'

The Bank Laws of August 1914 *'established* Darlehnskassen*, loan banks where people, firms, and municipalities could mortgage their illiquid securities and commodity assets as collateral for money in the form of* Darlehnskassenscheine*, loan bureau bills accepted as legal tender at all government agencies. Darlehnskassen helped Germany avoid a general moratorium, unique among the belligerent countries, and gave private enterprises and local governments a place to discount bills. Beyond this, the Reich encouraged loans secured from the Darlehnskassen to be invested in federal war bonds. People could then take these war bonds to the Darlehnskassen as collateral for yet further loans, creating the potential for a continuous cycle of money production. The key aspect of the Darlehnskassenscheine was that they did not have to be covered by gold held at the Reichsbank. Rather, when Darlehnskassenscheine were held by the Reichsbank, they acted as a gold surrogate that covered the issue of new Reichsbank notes.'* (Gross, p.229)

Darlehnkassen had been established with success in the crises of 1848, 1866 and 1870. Although castigated by historians as one of the causes of inflation, they were almost universally welcomed by economists at the time apart, Gross says, from Bendixen. But Bendixen's main objection seems to have been just that it was an unnecessarily cumbersome way of going about the business of issuing money.

As a result of the Hindenburg plan 'The amount of currency in circulation in Germany rose 599 percent by 1918. Among Germany's main competitors Britain, France, and Russia, the money supply rose 91, 386, and 1,102 percent respectively.' However, although this accompanied a high rate of inflation it wasn't that much higher than in Britain: 'The gap between Germany and Great Britain appears less drastic when measuring inflation by the cost of living or wholesale price indices - which by 1918 in Germany had risen 105 and 204 percent respectively against 127 and 110 in Great Britain. Both of these indices reflect Germany's price controls.' (p.235)

Since the Reichsbank notes were still limited by law to three times the amount of gold 'the Reichsbank had either to increase its gold reserves, circumvent the one third limit by means of the *Darlehnskassen* or follow some combination of the two policies.' But the policy of appealing to the public for gold had been so successful in the early stages of the war that there was now very little left to be culled: 'virtually no gold remained in private circulation.' This had been a source of considerable pride: 'Helfferich argued that the German public could rest easy because the Rieichsbank had achieved the highest gold to paper ratio among central banks, whereas the British public should be nervous on account of their central bank's low gold reserves.' Now, however, he had to fall back on the *Darlehnskassen.*

AND IN BRITAIN

But what about the British understanding of the role of gold? J.M.Keynes had been following the German bullionist/nominalist controversy and in 1914 he published a review of the *Theorie des Geldes und der Umlaufsmittel* (Theory of Money and Credit; Munich and Leipzig, 1912) by Ludwig von Mises, giving the bullionist point of view, and of Bendixen's *Geld und Kapital* (Money and Capital; Leipzig, 1912) expressing sympathy for Bendixen:

[Bendixen says that the] *'old "metallist" view of money is superstitious, and Dr. Bendixen trounces it with the vigour of a convert. Money is the creation of the State; it is not true to say that gold is international currency, for international contracts are never made in terms of gold, but always in terms of some national monetary unit; there is no essential or important distinction between notes and metallic money; money is the measure of value, but to regard it as having value itself is a relic of the view that the value of money is regulated by the value of the substance of which it is made, and is like confusing a theatre ticket with the performance.*

'With the exception of the last, the only true interpretation of which is purely dialectical, these ideas are undoubtedly of the right complexion. It is probably true that the old "metallist" view and the theories of regulation of note issue based on it do greatly stand in the way of currency reform, whether we are thinking of economy and elasticity or of a change in the standard; and a gospel which can be made the basis of a crusade on these lines is likely to be very useful to the world, whatever its crudities or terminology.'[10]

It is interesting in this context to note that von Mises blames Bendixen and Knapp for the German travails of the 1920s:

'The idea that monetary and credit expansion make business good, create "full employment," and bring general prosperity was the essence of the ideas of Mercantilism. The fallacies implied

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[10] See http://socialdemocracy21stcentury.blogspot.com/2012/03/keynes-on-metallism-versus-chartalism.html.

were utterly exploded by the economists whom the Prussian Historical School and their modern followers, Keynesians and the American advocates of unbalanced budgets, disparage as orthodox ...

'Among the gravediggers of the German people's prosperity and the German currency, Friedrich Bendixen occupies an eminent place. He was a bank manager and the author of many books and articles dealing with monetary matters. His prestige and his influence on the course of the Reich's financial policy were enormous.

'When in the first World War the mark's purchasing power declined and concomitantly foreign exchange rates went up, Bendixen trumpeted that this was a rather fortunate event. For, he said, it made it possible for the Germans to sell their holdings of foreign securities at a profit ...

'The exporter makes an apparent profit—in domestic currency—although he may sell at a lower price in foreign currency. But what really goes on is that he gives the domestic products away at a price which enables him only to buy a smaller quantity of foreign products. It is true, the nation whose currency has been devalued exports more during this interval, but it gets in exchange only less or, at least, not more than previously for a smaller quantity exported.

'This is what the economists have in mind when speaking of "apparent" gains. These gains are the result of false reckoning and self-deception ...

'Of course, the Germans, steeped in the monetary fallacies of Bendixen and Knapp, were not aware of this fact. Neither were the foreign bankers and investors shrewd enough to judge correctly the plight of the German big banks and of many of the big German business concerns. In the twenties foreign loans to the Reich, the member states, the municipalities and to the banks and big business amounted to about 20 billion Reichsmarks. Besides, foreigners invested $5 billions directly in German business. This huge inflow—against which reparation payments of about $10.8 billions had to be held—disguised for a few years the frailty of the big banks. When the depression ended foreign lending to Germany, the collapse of the banks could no longer be delayed. It occurred in 1931 as the payoff both of inflation and of ignorance of fundamental economic issues.'[11]

Keynes became an adviser to the British Treasury at the beginning of the war under Lloyd George as Chancellor of the Exchequer, securing a salaried job early in 1915 as assistant to Sir George Paish, appointed by Lloyd George as his chief adviser on financial affairs. But Paish very soon departed the scene following a nervous breakdown, leaving Keynes in place. In May 1915, when Asquith brought the Conservatives into the government, Lloyd George became Minster of Munitions and was replaced as Chancellor of the Exchequer by Reginald McKenna who, as Churchill's predecessor as First Lord of the Admiralty, favoured naval blockade rather than a land based military commitment as Britain's main contribution to the war effort.[12] The Liberal war policy associated with McKenna and Asquith and supported by Keynes was that

[11] Quoted from an article originally published in the *Commercial and Financial Chronicle*, March 7, 1946. Taken from the website of the Foundation for Economic Education.

[12] There is a very good account of McKenna's involvement not just during the war but in planning the aggression against Germany In Eamon Dyas: *Blockading the Germans*, Belfast Eduational and Historical Society, 1918.

Britain should be as little involved in the actual fighting as possible but should instead subsidise the war efforts of its allies. In the account by Robert Skidelsky:

'The conference which Keynes attended in Paris from 2 to 5 February [1915, while Lloyd George was still Chancellor and while Keynes was still, in Skidelsky's account, 'simply a junior adviser among many'] *was the first inter-Ally conference. It inaugurated the whole complex system of inter-Ally war credits. Russia, and to a lesser extent France, could no longer export enough goods or gold to pay for their purchases abroad of essential war materials. Britain, whose international financial position was much stronger, had to start financing them. Britain and France agreed to make a joint loan to Russia; Russia agreed to increase its wheat exports as soon as the Dardanelles was open. Russia and France also agreed to transfer gold to the Bank of England. Britain's first credit to France followed in April. From the decisions taken at the conference stemmed the whole post-war debt problem, since it was decided that transfers were to take the form of loans, not grants. Once Britain started to finance its allies, it was inevitable that it would seek to control their foreign spending, so as to make sure that the money was not frittered away or simply used to support the exchange value of their currencies. Financial control led, by stages, to a centralised buying system, with Allied orders abroad placed through Britain, and paid for by British credits earmarked for Allied accounts at the Bank of England. This was the system which Keynes helped to build up over the next two years, and over which he came to preside. Its evolution can be traced in the Anglo-French agreement of April 1915, the Anglo-Russian agreement of September 1915, the Anglo-Italian agreements of June and November 1915 and the Four Power Protocol of July 1916. Britain would advance its allies credits for their purchase of war materials in return for some control over their buying, and the deposit of gold in London as partial collateral. Purchasing Committees were set up in London to handle the orders. Keynes played a prominent part in the negotiation of these agreements. His influence on the initial decisions taken in Paris comes out most strongly in his insistence that Russia be obliged to hold some portion of its gold reserves in London. "Only the English,"'he minuted characteristically, 'have realised that the main use of gold reserves is to be used."'*[13]

In an article published in December 1914, Keynes had ridiculed what was effectively the German policy of keeping gold safely stored in the vaults in order to maintain a fixed ratio with the quantity being issued of paper money:

'Ratios, which began by being little more than the results of chance, have been sanctified by time. ... a gold reserve is thought of as being sone sort of charm, the presence of which is valuable quite apart from there being any idea of dissipating it - as the emblem, rather than the prop, of respectability. It would be consistent with these ideas to melt the reserve into a great golden image of the chief cashier and place it on a monument so high that it could never be got down again. If any doubt comes to be felt about the financial stability of the country, a glance upwards at the image will, it is thought, restore confidence. If confidence is not restored, this only shows that the image is not quite big enough.'

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[13] Robert Skidelsky: *John Maynard Keynes, Vol 1 - Hopes betrayed, 1883-1920*, London, Macmillan, 1992 (first published 1983), pp.298-9

He continued: *'If it proves one of the after effects of the present struggle that gold is at last deposed from its despotic control over us and reduced to the position of a constitutional monarch, a new chapter of history will be opened. Man will have made another step forward in the attainment of self-government.'*[14]

The use Keynes envisaged for gold was to facilitate the international movement of money - in the first place, Britain lending to its allies, in the second place borrowing from the US, a process that became increasingly onerous as conscription was introduced and Britain, following the desire of Lloyd George and the Conservatives, became more involved in fighting on its own behalf. Borrowing from the US was hardly an option available to the Germans. According to Gross (p.250): 'In New York before 1917, Germany was able to raise $27 million in loans in comparison with over $2 billion for the Entente.' He explains in a footnote that German attempts to borrow from the US had to contend with the dominance of the pro-British J.P.Morgan. The total borrowing of the central powers in New York has been calculated at $35 million. Meanwhile the bulk of money floated as war loans in Switzerland went to France. Germany, then, much more than the allies, was very heavily reliant on her own resources.

According to Skidelsky: 'The stability of the Allied exchanges and the whole structure of inter-Ally finance, depended on Britain being able to borrow enough dollars in the United States to pay for Allied spending. By September it was paying out over $200m a month in the U.S.A. (about two-fifths of its total war expenditure). Of this about half was being paid for by dwindling reserves of gold and the same of British-owned American and Canadian securities. The rest was being borrowed by the sale of Treasury bills, public issues of U.K. bonds, and collateral loans.' At the same time 'By mid-1916 Britain was paying for the whole of Italy's foreign war spending, most of Russia's, two-thirds of France's, half of Belgium's and Serbia's.' In October 1916, 'Keynes drew the sensible conclusion that "the policy of this country towards the U.S.A. should be so directed as not only to avoid any form of reprisal or active irritation but also to conciliate and please."' Skidelsky comments: 'These words fix the moment when financial hegemony passed irrevocably across the Atlantic.'[15]

GERMANY BEFORE THE SECOND WORLD WAR - THE *MEFO* BILLS

I want to finish with a few words about the MEFO bills, one of the means by which, in four years, Germany advanced from a broken economy with over six million unemployed, deprived by international law of the means of defending itself, to a military power capable of taking on and defeating almost the whole of Europe. The architect of the MEFO bills was Hjalmar Schacht, who had been President of the Reichsbank in 1924 and as such responsible for introducing the new gold-based reichsmark (the old gold-based mark with twelve noughts struck off) which finally put an end to the period of hyper-inflation. Schacht resigned as President of the

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[14] Keynes in the *Economic Journal*, (of which he was editor), November 1914. The first quote is given in Gross: Confidence and Gold, p. 239, the second in Skidelsky: Keynes Vol 1, p.292), who also in the text gives the date of December not, as in the footnotes, November.

[15] Skidelsky: Keynes Vol 1, pp.333 and 335.

Reichsbank in protest against the terms of the reorganisation of reparations payments under the Young Plan (which he had helped to negotiate). It was the struggle against the Young Plan which brought him together with the coalition of nationalist groups that included the National Socialists. He played an important role in the 'business circle' of leading industrialists formed to influence Hitler towards a more modest, business friendly economic policy. He was recalled to the presidency of the Reichsbank soon after the National Socialists came to power and was appointed Minister of Economic Policy in August 1934.[16]

In his book, *The Magic of Money*, written after the war, Schacht presents himself as a fairly conservative, orthodox economist, a believer in gold, distrustful of paper money: 'The war of 1914 provided telling proof of the fact that state guaranteed paper money, unlike gold and silver coins, does not represent any substantial value.'[17] He insists that war should be paid for out of taxation rather than loans (though he seems curiously to exaggerate the extent to which Germany's opponents in the First World War relied on taxation); and he denies responsibility for the invention of the rentenmark:

'From a point of view of currency theory, the Rentenmark was a misconception. Not even Helfferich could close his ears to the objections which were advanced. He had to admit that the new money was no use in effecting international payments, and that it could only constitute an emergency bridge to the gold standard. He also admitted that in addition to the Rentenmark a foreign bill or gold Mark would, as I had suggested, be needed in order to facilitate the transmission of foreign payments.

'Helfferich' s change of front brought him generally into line with my own thoughts on the matter. Soon after, when I became Commissioner for Currency and then President of the Reichsbank, I made every endeavour to take the Rentenmark out of circulation as quickly as possible and finally to abolish it altogether, at the same time bringing the Reichsmark back to full validity. To this end the Reichsbank gave the Rentenmark parity with the new Reichsmark. The Reichsbank exchanged every Rentenmark al pari *into Reichsmark, or, in other words the Reichsbank guaranteed the Rentenmark exactly as it did the Reichsmark.'* (p.67)

Schacht would almost certainly have denied the claim sometimes made that the MEFO bill was a non-gold based *fiat* currency. It was a bill issued on behalf of a company specially invented for the purpose - the *Metallurgische Forschungsgesellschaft* (Metal Research Company) - used to pay for government contracts. It could be exchanged for ordinary gold-based reichsmarks but had this been done in large quantities the system would have collapsed. The ingenuity of the system was the incentive provided not to do so. Schacht explains:

'The Reich guaranteed all obligations entered into by MEFO, and thus also guaranteed the MEFO bills in full. In essence all the Reichsbank' s formal requirements were met by this scheme. It was a question of financing the delivery of goods; MEFO bills were therefore commodity bills. They rested on a threefold obligation: that of drawer, acceptor and Reich. This

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[16] There is a useful account in Arthur Schweitzer: 'Business Policy in a Dictatorship', *The Business History Review*, Vol. 38, No. 4 (Winter, 1964), pp. 413-438

[17] Hjalmar Schacht: *The Magic of money*, translated by Paul Erskine, London, Oldbourne Book Co Ltd, 1967, p.94

provided the Reichsbank with every justification for discounting the bills, and, although it was put to every test by the Reichsbank's directorate in collaboration with the country's best legal brains and economists, they agreed unanimously that it was valid.

'The Reichsbank declared itself ready to prolong the bills, which true to the form laid down were drawn on three months' credit, to a maximum of five years if so required, and this point was new and unusual. Each bill could thus be extended by a further three months, nineteen times running. This was necessary, because the planned economic reconstruction could not be accomplished in three months, but would take a number of years. By and large such extensions by themselves were nothing new with the Reichsbank; it was quite common to prolong agricultural bills, but an extension over five years, together with a firm declaration that such extensions would be granted, that was most unusual.

'One other aspect was even more unusual. The Reichsbank undertook to accept all MEFO bills at all times, irrespective of their size, number, and due date, and change them into money. The bills were discounted at a uniform rate of four per cent. By these means the MEFO bills were almost given the character of money, and interest-carrying money at that. Banks, savings banks, and firms could hold them in their safes exactly as if they were cash. Over and above this they proved to be the best of all interest-bearing liquid investments, in contrast to long-dated securities. In all, MEFO bill credit transactions took place over a period of four years, and had by 1938 reached a total volume of twelve milliard [ie 12 billion, understanding billion as a thousand million - PB] *Marks. This amount was not issued all at the same time, but in step with the progress in production. On average, bills to the value of three milliards were issued each year. Whether this was the right amount, whether more or less was to be issued, depended on the currency policy the Reichsbank decided to pursue. The politicians had different ideas. They wanted the highest possible number over the longest possible period. After a hard-fought battle, the decision went in favour of the Reichsbank.*

'This decision was of great importance for currency policy. It granted the Reichsbank the opportunity - of which it subsequently availed itself- to suspend the MEFO transactions when the currency position required that. it should do so. The Reichsbank's task was made easier by the fact that until 1938 some half of the MEFO bills in issue at any one time were always taken up and held by the market, and thus not presented to the Reichsbank for discounting.' (pp. 112-3)

The effect was that a large amount of money was in circulation in addition to the amount that could be justified by the gold reserves held by the Reichsbank.[18] It should be said that when in April 1933 the US suspended gold convertibility and allowed the dollar to depreciate, Germany did not follow its example. According to the account by Adam Tooze: 'in the spring of 1933, Schacht seconded Hitler in denouncing any currency experiments. Pandering to popular sentiment, Hitler and Schacht made the defence of the official gold value of the Reichsmark into a symbol of the new regime's reliability and trustworthiness. Unlike in 1923, it was now the

[18] Actually I haven't yet been able to find anything very definite about the policy regarding gold reserves or the ratio between gold actually held and the issuance of notes. I'm assuming that the 3 to 1 rule was still in force.

dollar not the Reichsmark that was plunging in value on the foreign exchanges.'[19] According to Emil Puhl, who had been a director of the Reichsbank at the time when Schacht was President: 'The devaluation of the currencies of other leading countries increased the difficulties of Germany's foreign trade position. Earlier the Bruening Government had decided not to devalue the RM because it felt itself bound to the international agreements on which the German currency was based, and it was unwilling to violate these international agreements. These deflationary policies did not prove popular with the German people and the leadership of the German government passed successively from Bruening to von Papen, to von Schleicher and to Hitler. Von Papen and von Schleicher, who held office briefly, did not devalue the RM officially. Hitler too refused to devalue the RM officially through fear that such a move would cost him the support of the German people, who had a deadly fear of inflation and who believed that devaluation meant inflation.'[20] Tooze points out that though 'Germany would be left completely uncompetitive in every export market in the world ... the dollar's devaluation also brought a huge windfall, by reducing the Reichsmark value of the debts Germany owed to the United States.'

But Schacht's commitment to maintaining the value of the mark was clearly much more than a simple matter of 'pandering to popular sentiment'. In an interview given in September 1937 to S.R.Fuller, acting as a representative of President Roosevelt, Schacht complained against England's going off the gold standard and stressed Germany's commitment to a policy of 'stabilisation' of foreign exchange rates:

'S[chacht]: If an attempt is made to get stabilization, I assure you Germany will do her cooperative part. Germany wants to pay her debts; she will pay them as soon as a stabilized exchange is reached."
[...]
F[uller]: "Can you hold the German mark where it is?"
S: "Yes : because we control our exchanges."
F: "Can you hold the mark regardless of what the other gold countries may do, even if Holland and/or France go off the gold standard?"
S: "Yes."
F: "For how long?"
S: "Indefinitely."
F: "By that you mean until you have worked out your present domestic problems, both agricultural and industrial?"
S: "Yes, until we have completed a German world of the mark where our raw material necessities can be produced and our excess workmen can be employed: a German world of the mark."'[21]

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[19] Adam Tooze: *The Wages of destruction,* Penguin Books, 2007 (first published 2006), p.41

[20] *Nazi conspiracy and aggression* [documents prepared for the Nuremberg trials} *Vol VII*, pp.496-7

[21] Ibid, p.507. The last remark is interesting. It's not a theme I'm developing here but in the course of the interview Schacht insists that Germany needs 'colonies' in order to create a world in which Germany could access raw materials using the mark - much as Britain had the advantage of being able to access raw materials in the Empire using sterling.

Schacht handled the trade balance with another much admired expedient, entering into agreements with countries on a one by one basis by which the amount of imports Germany accepted would be balanced by the other party's willingness to accept an equivalent quantity of German exports - effectively a system of barter. Puhl again:

'Schacht in his dual capacity as president of the Reichsbank and Minister of Economics developed measures which he announced under the title of the "New Plan" to broaden the control over the German economy. It provided totalitarian controls over devisen and commodities. The program under the "New Plan" put Germany's foreign trade largely on a barter basis. Schacht, by these measures, sought to restrict the demand for foreign exchange and to increase its supply. He was successful in restricting the demand for foreign exchange by various measures suspending the service on Germany's foreign indebtedness, by freezing other claims of foreigners on Germany, by a stringent system of import controls and by eliminating foreign travel and other unessential foreign expenditures.

'To increase the available supply of foreign exchange, Schacht repeatedly requisitioned all existing foreign exchange reserves of German residents, required all foreign exchange arising out of current exports and other transactions to be sold to the Reichsbank and by developing new export markets. Exports were encouraged by direct subsidies and by accepting partial payment in German foreign bonds or in restricted marks which could be acquired by foreign importers at a substantial discount.

'Schacht actively developed barter with foreign customers and "clearing agreements" with foreign nations. Under Schacht's leadership Germany was quite successful in developing her foreign trade by these methods in Latin America and in southeastern Europe. He cleverly exploited Germany's bartering power in driving down import prices and raising export prices and, in some instances, securing credits from weaker countries which were subsequently used for imports from Germany.

'The clearing agreements were primarily for the purpose of obtaining raw materials for armament and food and export industries.

'Where clearing and payment agreements between governments or central banks were not used, the foreign exporters were often paid in mark balances called Aski marks, which they had to sell to the importers of German goods in their country. These marks sold at a substantial discount. Up to the end of 1938 clearing and payment agreements with over 40 countries had been concluded by Germany, and German foreign trade was dominated by this system. The share in Germany's export trade of countries using these methods exceeded eighty per cent in 1938.'[22]

Schacht showed a marked preference for imports of raw materials and a reticence with regard to the Nazi (and military) preference for autarchy and therefore for import substitution: 'Until the middle of 1936 Hitler did not concern himself in any way with the economic preconditions for waging a war. But he was repeatedly told that I, as Minister of Economic Affairs, emphasized

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[22] Ibid., pp.497-8. Skidelsky: Keynes vol iii gives an explanation of 'the Schachtian system', pp.228-230. See also N.I.Momthchiloff: 'Schachtian mercantilism', *Journal of Industrial Economics*, Aug 1954, Vol 2, No 3, pp.176-173.

the need to maintain foreign trade at a high level. In my deliberations with the government and business circles I always harked back to the fact that it was senseless to replace raw materials which could be imported cheaply with substitute materials expensively produced at home.' (Magic of Money, p.101). 1936 was the year in which Schacht began to lose control of the situation with the launching of the four year plan under the patronage of Göring, marking the transition from a policy of rearmament for defensive purposes to what Arthur Schweitzer calls 'a war economy in time of peace'. A policy of self sufficiency was outlined by Hitler in a memorandum written in September and proclaimed at the annual rally of the party in Nuremberg:

'On September 2, 1936, Hitler informed Schacht of the main ideas of his memorandum. Schacht argued against it by saying that a promotion of exports was the only solution of the raw material crisis, while Hitler's proposal would antagonize other countries and ruin Germany's foreign trade. Returned to his office, Schacht in greatest anxiety would call for General Thomas. To him Schacht proclaimed his opposition: "If we now shout our decision abroad to make ourselves economically independent, we cut our own throats, because we can no longer survive the transitory period of such a shift in economic policy". Schacht requested General Blomberg, through Thomas, to see to it that Hitler drop his plans of self-sufficiency. Blomberg heard the message but did nothing, thereby indicating his agreement with Hitler's policy directive.'[23]

For Schacht the circulation of the Mefo bills was certainly a risk but one that could be taken so long as Germany, in the circumstances of the depression, was operating so much under capacity, with well over six million unemployed and a large amount of unused and unusable plant. The money was kept under a very tight rein. This was no sloppy 'helicopter money' aimed at increasing demand among the general public, nor was it anything like 'quantitative easing', supplied to banks in the hopes that they would find profitable outlets for lending. Comparison has often been made with the ideas being developed by Keynes at the same time in the *General Theory* published in 1936 but insofar as it could be said to have involved 'demand management' the intention seems to have been to restrict consumer demand rather than to encourage it. It was purposeful state spending, very largely oriented towards rearmament, and this became the basis for Schacht's arraignment at the Nuremberg trials as part of the 'Nazi conspiracy' to wage aggressive war. Schacht argued at the trial that he had indeed helped with rearmament in the early 1930s:

'I considered an unarmed Germany in the center of Europe, surrounded by armed nations, as a menace to peace. I want to say that these states were not only armed but that they were, to a very large part, continuing to arm and arming anew. Especially two states which had not existed before, Czechoslovakia and Poland, were beginning to arm, and England, for example, was continuing to rearm, specifically with reference to her naval rearmament in 1935, et cetera. ... I considered the inequality of status between the countries surrounding Germany and Germany as a permanent moral and material danger to Germany.'

But, he complains:

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[23] Arthur Schweitzer: 'Foreign exchange crisis of 1936', *Zeitschrift für die gesamte Staatswissenschaft / Journal of Institutional and Theoretical Economics*, April 1962, Bd. 118, H. 2. (April 1962), p.275

'Mefo bills, of course, were a thoroughly risky operation, but they were absolutely not risky if they were connected with a reasonable financial procedure and to prove this I would say that if Herr Hitler, after 1937, had used the accruing funds to pay back the mefo bills, as had been intended - the money was available - then this system would have come to its end just as smoothly as I had put it in operation. But Herr Hitler preferred simply to refuse to pay the bills back, and instead to invest the money in further armament. I could not foresee that someone would break his word in such a matter too, a purely business matter.
'DR. DIX: But, if the Reich had met the bills and had paid, then means would no doubt have partly been lacking for further rearmaments and the taking up of the bills would therefore have curtailed armament. Is that a correct conclusion?
'SCHACHT: That, of course, was the very purpose of my wanting to terminate the procedure. I said if the mefo bills were not met, it would obviously show ill-will; then there would be further rearming, and that cannot be.[24]

In *The Magic of Money* (p.97) he says:

'It did not require the second sight of a prophet to forecast the unfortunate outcome of a war fought against opponents so rich in raw materials and foodstuffs as England and France. When Japan ventured to make war on America I commented "A country which produces nine million tons of steel a year can never win a war against a country which has a steel output of 90 million tons per year"'.

His disagreement with Hitler on the issue led to his dismissal as President of the Reichsbank in January 1939 (he had already resigned as Minister for Economic Policy) but he continued in favour as Minister without Portfolio until 1943. He was arrested in 1944 in connection with the July assassination plot against Hitler.

The period covered in this article sees Germany passing through the essentially defensive 1914-18 war; the loss of territory and resources, hyperinflation, reparations; the dependence on foreign, mainly US investment together with the collapse that followed the depression in the US; the rebuilding of industrial capacity and achievement of full employment under the Nazis and, though not discussed here, the period of the war when Germany occupied most of Europe and of the Western areas of the Soviet union. But in all that one thing at least seems to remain constant, and that is the 'cartelisation' of the economy - the dominance of large scale, technically advanced industrial enterprises, relatively free of the constraints of price competition nationally or internationally, operating on a scale that required extensive exports, but an economy also highly dependent on the import of raw materials and food not available to anything like the required quantities within Germany. This will be one of the main topics in the next in this series of articles when we enter into the substance of the understanding of post war European economic history offered by Joseph Halevi.

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[24] Nuremberg trial transcripts, 118th day (1st May 1946), pp.474-475