

unimportant when they are present (like oxygen, food, or security), but to think of nothing else when they are lacking.

Closely related to all this, and another example of the blindness of experts (even in their own areas), is the disastrous influence which economic, and especially financial, considerations played in security, especially rearmament, in the Long Armistice of 1919-1939. This had a double aspect. On the one hand, balanced budgets were given priority over armaments; on the other hand, once it was recognized that security was in acute danger, financial considerations were ruthlessly subordinated to rearmament, giving rise to an economic boom which showed clearly what might have been achieved earlier if financial consideration had been subordinated to the world's economic and social needs earlier; such action would have provided prosperity and rising standards of living which might have made rearming unnecessary.

Chapter 18—Reparations, 1919-1932

No subject occupied a larger portion of statesmen's energies than reparations during the decade after the war. For this reason, and because of the impact which reparations had on other issues (such as financial or economic recovery and international amity), the history of reparations demands a certain portion of our attention. This history can be divided into six stages, as follows:

1. The preliminary payments, 1919-1921
2. The London Schedule, May 1921-September 1924
3. The Dawes Plan, September 1924-January 1930
4. The Young Plan, January 1930-June 1931
5. The Hoover Moratorium, June 1931-July 1932
6. The Lausanne Convention, July 1932

The preliminary payments were supposed to amount to a total of 20,000 million marks by May 1921. Although the Entente Powers contended that only about 8,000 million of this had been paid, and sent Germany numerous demands and ultimatums in regard to these payments, even going so far as to threaten to occupy the Ruhr in March 1921 in an effort to enforce payment, the whole matter was dropped in May when the Germans were presented with the total reparations bill of 132,000 million marks. Under pressure of another ultimatum, Germany accepted this bill and gave the victors bonds of indebtedness to this amount. Of these, 82 billions were set aside and forgotten. Germany was to pay on the other 50 billion at a rate of 2.5 billion a year in interest and 0.5 billion a year to reduce the total debt.

Germany could pay these obligations only if two conditions prevailed: (a) if it had a budgetary surplus and (b) if it sold abroad more than it bought abroad (that is, had a favorable balance of trade). Under the first condition there would accumulate in the hands of the German government a quantity of German currency beyond the amount needed for current expenses. Under the second condition, Germany would receive from abroad an excess of foreign exchange (either gold or foreign money) as payment for the excess of her exports over her imports. By exchanging its budgetary surplus in marks for the foreign-exchange surplus held by her citizens, the German government would be able to acquire this foreign exchange and be able to give it to its creditors as reparations. Since neither of these conditions generally existed in the period 1921-1931, Germany could not, in fact, pay reparations.

The failure to obtain a budgetary surplus was solely the responsibility of the German government, which refused to reduce its own expenditures or the standards of living of its own people or to tax them sufficiently heavily to yield such a surplus. The failure to obtain a favorable balance of trade was the responsibility equally of the Germans and of their creditors, the Germans making little or no effort to reduce their purchases abroad (and thus reduce their own standards of living), while the foreign creditors refused to allow a free flow of German goods into their own countries on the argument that this would destroy their domestic markets for locally produced goods. Thus it can be said that the Germans were unwilling to pay reparations, and the creditors were unwilling to accept payment in the only way in which payments could honestly be made, that is, by accepting German goods and services.

Under these conditions, it is not surprising that the London Schedule of reparations payments was never fulfilled. This failure was regarded by Britain as proof of Germany's inability to pay, but was regarded by France as proof of Germany's unwillingness to pay. Both were correct, but the Anglo-Americans, who refused to allow France to use the duress necessary to overcome German unwillingness to pay, also refused to accept German goods to the amount necessary to overcome German inability to pay. As early as 1921, Britain, for example, placed a 26 percent tax on all imports from Germany. That Germany could have paid in real goods and services if the creditors had been willing to accept such goods and services can be seen in the fact that the real per capita income of the German people was about one-sixth higher in the middle 1920's than it had been in the very prosperous year 1913.

Instead of taxing and retrenching, the German government permitted an unbalanced budget to continue year after year, making up the deficits by borrowing from the Reichsbank. The result was an acute inflation. This inflation was not forced on the Germans by the need to pay reparations (as they claimed at the time) but by the method they took to pay reparations (or, more accurately, to avoid payment). The inflation was not injurious to the influential groups in German society, although it was generally ruinous to the middle classes, and thus encouraged the extremist elements. Those groups whose property was in real wealth, either in land or in industrial plant, were benefitted by the inflation which increased the value of their properties and wiped away their debts (chiefly mortgages and industrial bonds). The German mark, which at par was worth

about 20 to the pound, fell in value from 305 to the pound in August 1921 to 1,020 in November 1921. From that point it dropped to 80,000 to the pound in January 1923, to 20 million to the pound in August 1923, and to 20 billion to the pound in December 1923.

In July 1922, Germany demanded a moratorium on all cash payments of reparations for the next thirty months. Although the British were willing to yield at least part of this, the French under Poincaré pointed out that the Germans had, as yet, made no real effort to pay and that the moratorium would be acceptable to France only if it were accompanied by "productive guarantees." This meant that the creditors should take possession of various forests, mines, and factories of western Germany, as well as the German customs, to obtain incomes which could be applied to reparations. On January 9, 1923, the Reparations Commission voted 3 to 1 (with Britain opposing France, Belgium, and Italy) that Germany was in default of her payments. Armed forces of the three nations began to occupy the Ruhr two days later. Britain denounced this act as illegal, although it had threatened the same thing on less valid grounds in 1921. Germany declared a general strike in the area, ceased all reparations payments, and adopted a program of passive resistance, the government supporting the strikers by printing more paper money.

The area occupied was no more than 60 miles long by 30 miles wide but contained 10 percent of Germany's population and produced 80 percent of Germany's coal, iron, and steel and 70 percent of her freight traffic. Its railway system, operated by 170,000 persons, was the most complex in the world. The occupation forces tried to run this system with only 12,500 troops and 1,380 cooperating Germans. The non-cooperating Germans tried to prevent this, not hesitating to use murder for the purpose. Under these conditions it is a miracle that the output of the area was brought up to one-third its capacity by the end of 1923. German reprisals and Allied countermeasures resulted in about 400 killed and over 2,100 wounded—most of the casualties (300 and 2,000 respectively) being inflicted by Germans on Germans. In addition almost 150,000 Germans were deported from the area.

The German resistance in the Ruhr was a great strain on Germany, both economically and financially, and a great psychological strain on the French and Belgians. At the same time that the German mark was being ruined, the occupying countries were not obtaining the reparations they desired. Accordingly, a compromise was reached by which Germany accepted the Dawes Plan for reparations, and the Ruhr was evacuated. The only victors in the episode were the British, who had demonstrated that the French could not use force successfully without British approval.

The Dawes Plan, which was largely a J. P. Morgan production, was drawn up by an international committee of financial experts presided over by the American banker Charles G. Dawes. It was concerned only with Germany's ability to pay, and decided that this would reach a rate of 2.5 billion marks a year after four years of reconstruction. During the first four years Germany would be given a loan of \$800 million and would pay a total of only 5.17 billion marks in reparations. This plan did not supersede the German reparations obligation as established in 1921, and the difference between the

Dawes payments and the payments due on the London Schedule were added to the total reparations debt. Thus Germany paid reparations for five years under the Dawes Plan (1924-1929) and owed more at the end than it had owed at the beginning.

The Dawes Plan also established guarantees for reparations payments, setting aside various sources of income within Germany to provide funds and shifting the responsibility for changing these funds from marks into foreign exchange from the German government to an agent-general for reparations payments who received marks within Germany. These marks were transferred into foreign exchange only when there was a plentiful supply of such exchange within the German foreign-exchange market. This meant that the value of the German mark in the foreign-exchange market was artificially protected almost as if Germany had exchange control, since every time the value of the mark tended to fall, the agent-general stopped selling marks. This allowed Germany to begin a career of wild financial extravagance without suffering the consequences which would have resulted under a system of free international exchange. Specifically, Germany was able to borrow abroad beyond her ability to pay, without the normal slump in the value of the mark which would have stopped such loans under normal circumstances. It is worthy of note that this system was set up by the international bankers and that the subsequent lending of other people's money to Germany was very profitable to these bankers.

Using these American loans, Germany's industry was largely reequipped with the most advanced technical facilities, and almost every German municipality was provided with a post office, a swimming pool, sports facilities, or other nonproductive equipment. With these American loans Germany was able to rebuild her industrial system to make it the second best in the world by a wide margin, to keep up her prosperity and her standard of living in spite of the defeat and reparations, and to pay reparations without either a balanced budget or a favorable balance of trade. By these loans Germany's creditors were able to pay their war debts to England and to the United States without sending goods or services. Foreign exchange went to Germany as loans, back to Italy, Belgium, France, and Britain as reparations, and finally back to the United States as payments on war debts. The only things wrong with the system were (a) that it would collapse as soon as the United States ceased to lend, and (b) in the meantime debts were merely being shifted from one account to another and no one was really getting any nearer to solvency. In the period 1924-1931, Germany paid 10.5 billion marks in reparations but borrowed abroad a total of 18.6 billion marks. Nothing was settled by all this, but the international bankers sat in heaven, under a rain of fees and commissions.

The Dawes Plan was replaced by the Young Plan at the beginning of 1930 for a variety of reasons. It was recognized that the Dawes Plan was only a temporary expedient, that Germany's total reparations obligation was increasing even as she paid billions of marks, because the Dawes Plan payments were less than the payments required by the London Schedule; that the German foreign-exchange market had to be freed in order that Germany might face the consequences of her orgy of borrowing, and that Germany "could not pay" the standard Dawes payment of 2.5 billion marks a year which was required in the fifth and following years of the Dawes Plan. In addition,

France, which had been forced to pay for the reconstruction of her devastated areas in the period 1919-1926, could not afford to wait for a generation or more for Germany to repay the cost of this reconstruction through reparations payments. France hoped to obtain a larger immediate income by "commercializing" some of Germany's reparations obligations. Until this point all the reparations obligations were owed to governments. By selling bonds (backed by German's promise to pay reparations) for cash to private investors France could reduce the debts she had incurred for reconstruction and could prevent Britain and Germany from making further reductions in the reparations obligations (since debts to private persons would be less likely to be repudiated than obligations between governments).

Britain, which had funded her war debts to the United States at 4.6 billion dollars in 1923, was quite prepared to reduce German reparations to the amount necessary to meet the payments on this war debt. France, which had war debts of 4 billion dollars as well as reconstruction expenses, hoped to commercialize the costs of the latter in order to obtain British support in refusing to reduce reparations below the total of both items. The problem was how to obtain German and British permission to "commercialize" part of the reparations. In order to obtain this permission France made a gross error in tactics: she promised to evacuate all of the Rhineland in 1930, five years before the date fixed in the Treaty of Versailles, in return for permission to commercialize part of the reparations payments.

This deal was embodied in the Young Plan, named after the American Owen D. Young (a Morgan agent), who served as chairman of the committee which drew up the new agreements (February to June 1929). Twenty governments signed these agreements in January 1930. The agreement with Germany provided for reparations to be paid for 59 years at rates rising from 1.7 billion marks in 1931 to a peak of 2.4 billion marks in 1966 and then declining to less than a billion marks in 1988. The earmarked sources of funds in Germany were abolished except for 660 million marks a year which could be "commercialized," and ail protection of Germany's foreign-exchange position was ended by placing the responsibility for transferring reparations from marks to foreign currencies squarely on Germany. To assist in this task a new private bank called the Bank for International Settlements was established in Switzerland at Basle. Owned by the chief central banks of the world and holding accounts for each of them, the Bank for International Settlements was to serve as "a Central Bankers' Bank" and allow international payments to be made by merely shifting credits from one country's account to another on the books of the bank.

The Young Plan, which was to have been a final settlement of the reparations question, lasted for less than eighteen months. The crash of the New York stock market in October 1929 marked the end of the decade of reconstruction and opened the decade of destruction between the two wars. This crash ended the American loans to Germany and thus cut off the flow of foreign exchange which made it possible for Germany to appear as if it were paying reparations. In seven years, 1924-1931, the debt of the German federal government went up 6.6 billion marks while the debts of German local governments went up 11.6 billion marks. Germany's net foreign debt, both public and

private, was increased in the same period by 18.6 billion marks, exclusive of reparations. Germany could pay reparations only so long as her debts continued to grow because only by increasing debts could the necessary foreign exchange be obtained. Such foreign loans almost ceased in 1930, and by 1931 Germans and others had begun a "flight from the mark," selling this currency for other monies in which they had greater confidence. This created a great drain on the German gold reserve. As the gold reserve dwindled, the volume of money and credit erected on that reserve had to be reduced by raising the interest rate. Prices fell because of the reduced supply of money and the reduced demand, so that it became almost impossible for the banks to sell collateral and other properties in order to obtain funds to meet the growing demand for money.

At this point, in April 1931, Germany announced a customs union with Austria. France protested that such a union was illegal under the Treaty of Saint-Germain, by which Austria had promised to maintain its independence from Germany. The dispute was referred to the World Court, but in the meantime the French, to discourage such attempts at union, recalled French funds from both Austria and Germany. Both countries were vulnerable. On May 8, 1931, the largest Austrian bank, the Credit-Anstalt (a Rothschild institution), with extensive interests, almost control, in 70 percent of Austria's industry, announced that it had lost 140 million schillings (about 520 million). The true loss was over a billion schillings, and the bank had really been insolvent for years. The Rothschilds and the Austrian government gave the Credit-Anstalt 160 million to cover the loss, but public confidence had been destroyed. A run began on the bank. To meet this run the Austrian banks called in all the funds they had in German banks. The German banks began to collapse. These latter began to call in all their funds in London. The London banks began to fall, and gold flowed outward. On September 21st England was forced off the gold standard. During this crisis the Reichsbank lost 200 million marks of its gold reserve and foreign exchange in the first week of June and about 1,000 million in the second week of June. The discount rate was raised step by step to 15 percent without stopping the loss of reserves but destroying the activities of the German industrial system almost completely.

Germany begged for relief on her reparations payments, but her creditors were reluctant to act unless they obtained similar relief on their war-debt payments to the United States. The United States had an understandable reluctance to become the end of a chain of repudiation, and insisted that there was no connection between war debts and reparations (which was true) and that the European countries should be able to pay war debts if they could find money for armaments (which was not true). When Secretary of the Treasury Mellon, who was in Europe, reported to President Hoover that unless relief was given to Germany immediately on her public obligations, the whole financial system of the country would collapse with very great loss to holders of private claims against Germany, the President suggested a moratorium on inter-governmental debts for one year. Specifically, America offered to postpone all payments owed to it for the year following July 1, 1931, if its debtors would extend the same privilege to their debtors.

Acceptance of this plan by the many nations concerned was delayed until the middle of July by French efforts to protect the payments on commercialized reparations and to

secure political concessions in return for accepting the moratorium. It sought a renunciation of the Austro-German customs union, suspension of building on the second pocket battleship, acceptance by Germany of her eastern frontiers, and restrictions on training of "private" military organizations in Germany. These demands were rejected by the United States, Britain, and Germany, but during the delay the German crisis became more acute. The Reichsbank had its worst run on July 7th; on the following day the North German Wool Company failed with a loss of 200 million marks; this pulled down the Schröder Bank (with a loss of 24 million marks to the city of Bremen where its office was) and the Darmstädter Bank (one of Germany's "Big Four Banks") which lost 20 million in the Wool Company. Except for a credit of 400 million marks from the Bank for International Settlements and a "standstill agreement" to renew all short-term debts as they came due, Germany obtained little assistance. Several committees of international bankers discussed the problem, but the crisis became worse, and spread to London.

By November 1931 all the European Powers except France and her supporters were determined to end reparations. At the Lausanne Conference of June 1932 German reparations were cut to a total of only 3 billion marks, but the agreement was never ratified because of the refusal of the United States Congress to cut war debts equally drastically. Technically this meant that the Young Plan was still in force, but no real effort was made to restore it and, in 1933, Hitler repudiated all reparations. By that date, reparations, which had poisoned international relations for so many years, were being swallowed up in other, more terrible, problems.

Before we turn to the background of these other problems, we should say a few words about the question of how much was paid in reparations or if any reparations were ever paid at all. The question arose because of a dispute regarding the value of the reparations paid before the Dawes Plan of 1924. From 1924 to 1931 the Germans paid about 10.5 billion marks. For the period before 1924 the German estimate of reparations paid is 56,577 billion marks, while the Allied estimate is 10,426 billion. Since the German estimate covers everything that could possibly be put in, including the value of the naval vessels they themselves scuttled in 1918, it cannot be accepted; a fair estimate would be about 30 billion marks for the period before 1924 or about 40 billion marks for reparations as a whole.

It is sometimes argued that the Germans really paid nothing on reparations, since they borrowed abroad just as much as they ever paid on reparations and that these loans were never paid. This is not quite true, since the total of foreign loans was less than 19 billion marks, while the Allies' own estimate of total reparations paid was over 21 billion marks. However, it is quite true that after 1924 Germany borrowed more than it paid in reparations, and thus the real payments on these obligations were all made before 1924. Moreover, the foreign loans which Germany borrowed could never have been made but for the existence of the reparations system. Since these loans greatly strengthened Germany by rebuilding its industrial plant, the burden of reparations as a whole on Germany's economic system was very slight.

Part Seven—Finance, Commercial and Business Activity: 1897-1947