

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

## Chapter 19—Reflation and Inflation, 1897-1925

We have already seen that valiant efforts were made in the period 1919-1929 to build up an international political order quite different from that which had existed in the nineteenth century. On the basis of the old order of sovereignty and international law, men attempted, without complete conviction of purpose, to build a new international order of collective security....

For these reasons, a real understanding of the economic history of twentieth century Europe is imperative to any understanding of the events of the period. Such an understanding will require a study of the history of finance, commerce, and business activity, of industrial organization, and of agriculture. The first three of these will be considered in this chapter from the beginning of the twentieth century to the establishment of the pluralist economy about 1947.

The whole of this half-century may be divided into six subdivisions, as follows:

1. Reflation, 1897-1914
2. Inflation, 1914-1925
3. Stabilization, 1922-1930
4. Deflation, 1927-1936
5. Reflation, 1933-1939
6. Inflation, 1939-1947

These periods have different dates in different countries, and thus overlap if we take the widest periods to include all important countries. But in spite of the difference in dates, these periods occurred in almost every country and in the same order. It should also be pointed out that these periods were interrupted by haphazard secondary movements. Of these secondary movements, the chief were the depression of 1921-1922 and the recession of 1937-1938, both periods of deflation and declining economic activity.

### The Financial Capitalists At Their Worst

Prices had been rising slowly from about 1897 because of the increased output of gold from South Africa and Alaska, thus alleviating the depressed conditions and agricultural distress which had prevailed, to the benefit of financial capitalists, from 1873. The outbreak of war in 1914 showed these financial capitalists at their worst, narrow in outlook, ignorant, and selfish, while proclaiming, as usual, their total devotion to the social good. They generally agreed that the war could not go on for more than six to ten

months because of the "limited financial resources" of the belligerents (by which they meant gold reserves). This idea reveals the fundamental misunderstanding of the nature and role of money on the part of the very persons who were reputed to be experts on the subject. Wars, as events have proved since, are not fought with gold or even with money, but by the proper organization of real resources.

## The International Bankers Devise a Secret

### Scheme to Enrich Themselves

The attitudes of bankers were revealed most clearly in England, where every move was dictated by efforts to protect their own position and to profit from it rather than by considerations of economic mobilization for war or the welfare of the British people. The outbreak of war on August 4, 1914, found the British banking system insolvent in the sense that its funds, created by the banking system for profit and rented out to the economic system to permit it to operate, could not be covered by the existing volume of gold reserves or by collateral which could be liquidated rapidly. Accordingly, the bankers secretly devised a scheme by which their obligations could be met by fiat money (so-called Treasury Notes), but, as soon as that crisis was over, they then insisted that the government must pay for the war without recourse to fiat money (which was always damned by bankers as immoral), but by taxation and by borrowing at high interest rates from bankers. The decision to use Treasury Notes to fulfill the bankers' liabilities was made as early as Saturday, July 25, 1914, by Sir John Bradbury (later Lord Bradbury) and Sir Frederick Atterbury at the latter's home. The first Treasury Notes were run off the presses at Waterlow and Sons the following Tuesday, July 28th, at a time when most politicians believed that Britain would stay out of the war. The usual Bank Holiday at the beginning of August was extended to three days during which it was announced that the Treasury Notes, instead of gold, would be used for bank payments. The discount rate was raised at the Bank of England from 3 percent to 10 percent to prevent inflation, a figure taken merely because the traditional rule of the bank stated that a 10 percent bank rate would draw gold out of the ground itself, and gold payments need be suspended only when a 10 percent rate failed.

## Governments Accept the Secret Plan of the Bankers

At the outbreak of the war, most of the belligerent countries suspended gold payments and, to varying degrees, accepted their bankers' advice that the proper way to pay for the war was by a combination of bank loans with taxation of consumption. The period within which, according to the experts, the war must cease because of limited financial resources eventually passed, and the fighting continued more vigorously than ever. The governments paid for it in various ways: by taxation, by fiat money, by borrowing from banks (which created credit for the purpose), and by borrowing from the people by selling war bonds to them. Each of these methods of raising money had a different effect upon the two chief financial consequences of the war. These were inflation and public debt. The effects of the four ways of raising money upon these two can be seen from the following table:

- a. Taxation gives no inflation and no debt.
- b. Fiat money gives inflation and no debt.
- c. Bank credit gives inflation and debt.
- d. Sales of bonds give no inflation but give debt.

### Paying for the War

It would appear from this table that the best way to pay for the war would be by taxation, and the worst way would be by bank credit. However, taxation sufficient to pay for a major war would have such a severe deflationary effect upon prices that economic production would not increase enough or fast enough. Any rapid increase in production is spurred by a small amount of inflation which provides the impetus of unusual profits to the economic system. Increase in public debt, on the other hand, contributes little of value to the effort toward economic mobilization.

From this point of view, it is not easy to say what method of financing a war is best. Probably the best is a combination of the four methods mixed in such a way that at the end there is a minimum of debt and no more inflation than was necessary to obtain complete and rapid economic mobilization. This would probably involve a combination of fiat money and taxation with considerable sales of bonds to individuals, the combination varying at different stages in the mobilization effort.

### At the End of the War the Governments Are

#### in Debt to the Bankers

In the period 1914-1918, the various belligerents used a mixture of these four methods, but it was a mixture dictated by expediency and false theories, so that at the end of the war all countries found themselves with both public debts and inflation in amounts in no wise justified by the degree of economic mobilization which had been achieved. The situation was made worse by the fact that in all countries prices continued to rise, and in most countries public debts continued to rise long after the Armistice of 1918.

The causes of the wartime inflation are to be found in both financial and economic spheres. In the financial sphere, government spending was adding tremendous amounts of money to the financial community, largely to produce goods which would never be offered for sale. In the economic sphere, the situation was different in those countries which were more completely mobilized than in those which were only partly mobilized. In the former, real wealth was reduced by the diversion of economic resources from making such wealth to making goods for destruction. In the others, the total quantity of real wealth may not have been seriously reduced (since much of the resources utilized in making goods for destruction came from resources previously unused, like idle mines,

idle factories, idle men, and so on) but the increase in the money supply competing for the limited amounts of real wealth gave drastic rises in prices.

### The Financial Leaders Use Deceptive Methods

While prices in most countries rose 200 to 300 percent and public debts rose 1,000 percent, the financial leaders tried to keep up the pretense that the money of each country was as valuable as it had ever been and that as soon as the war was ended the situation existing in 1914 would be restored. For this reason they did not openly abandon the gold standard. Instead, they suspended certain attributes of the gold standard and emphasized the other attributes which they tried to maintain. In most countries, payments in gold and export of gold were suspended, but every effort was made to keep gold reserves up to a respectable percentage of notes, and exchanges were controlled to keep them as near parity as possible. These attributes were achieved in some cases by deceptive methods. In Britain, for example, the gold reserve against notes fell from 52 percent to 18 percent in the month July-August 1914; then the situation was concealed, partly by moving assets of local banks into the Bank of England and using them as reserves for both, partly by issuing a new kind of notes (called Currency Notes) which had no real reserve and little gold backing. In the United States the percentage of reserves required by law in commercial banks was reduced in 1914, and the reserve requirements both for notes and deposits were cut in June 1917; a new system of "depository banks" was set up which required no reserves against government deposits created in them in return for government bonds. Such efforts were made in all countries, but everywhere the ratio of gold reserves to notes fell drastically during the war: in France from 60 percent to 11 percent; in Germany from 59 percent to 10 percent; in Russia from 98 percent to 2 percent; in Italy from 60 percent to 13 percent; in Britain from 53 percent to 32 percent.

### Inflation and Public Debts Continue after the War

The inflation and increase in public debts continued after the war ended. The causes for this were complicated, and varied from country to country. In general, (1) price fixing and rationing regulations were ended too soon, before the output of peacetime goods had risen to a level high enough to absorb the accumulated purchasing power in the hands of consumers from their efforts in war production; thus, the slowness of reconversion from war production to peace production caused a short supply at a time of high demand; (2) the Allied exchanges, which had been controlled during the war, were unpegged in March 1919 and at once fell to levels revealing the great price disequilibrium between countries; (3) purchasing power held back during the war suddenly came into the market; (4) there was an expansion of bank credit because of postwar optimism; (5) budgets remained out of balance because of reconstruction requirements (as in France or Belgium), reparations (as in Germany), demobilization expenses (as in the United States, Italy, and so on); and (6) production of peacetime goods was disrupted by revolutions (as in Hungary, Russia, and so on) or strikes (as in the United States, Italy, France, and so on).

### Postwar Inflation Had Evil Results

Unfortunately, this postwar inflation, which could have accomplished much good (by increasing output of real wealth) was wasted (by increasing prices of existing goods) and had evil results (by destroying capital accumulations and savings, and overturning economic class lines). This failure was caused by the fact that the inflation, though unwanted everywhere, was uncontrolled because few persons in positions of power had the courage to take the steps necessary to curtail it. In the defeated and revolutionary countries (Russia, Poland, Hungary, Austria, and Germany), the inflation went so far that the former monetary units became valueless, and ceased to exist. In a second group of countries (like France, Belgium, and Italy), the value of the monetary unit was so reduced that it became a different thing, although the same name was still used. In a third group of countries (Britain, the United States, and Japan), the situation was kept under control.

### Public Debt and Economic Depression in America

As far as Europe was concerned, the intensity of the inflation increased as one moved geographically from west to east. Of the three groups of countries above, the second (moderate inflation) group was the most fortunate. In the first (extreme inflation) group the inflation wiped out all public debts, all savings, and all claims on wealth, since the monetary unit became valueless. In the moderate-inflation group, the burden of the public debt was reduced, and private debts and savings were reduced by the same proportion. In the United States and Britain the effort to fight inflation took the form of a deliberate movement toward deflation. This preserved savings but increased the burden of the public debt and gave economic depression.

### Chapter 20—The Period of Stabilization, 1922-1930

As soon as the war was finished, governments began to turn their attention to the problem of restoring the prewar financial system. Since the essential element in that system was believed to be the gold standard with its stable exchanges, this movement was called "stabilization." Because of their eagerness to restore the prewar financial situation, the "experts" closed their eyes to the tremendous changes which had resulted from the war. These changes were so great in production, in commerce, and in financial habits that any effort to restore the prewar conditions or even stabilize on the gold standard was impossible and inadvisable. Instead of seeking a financial system adapted to the new economic and commercial world which had emerged from the war, the experts tried to ignore this world, and established a financial system which looked, superficially, as much like the prewar system as possible. This system, however, was not the prewar system. Neither was it adapted to the new economic conditions. When the experts began to have vague glimmerings of this last fact, they did not begin to modify their goals, but insisted on the same goals, and voiced incantations and exhortations against the existing conditions which made the attainment of their goals impossible.

These changed economic conditions could not be controlled or exorcised by incantations. They were basically not results of the war at all, but normal outcomes of the economic development of the world in the nineteenth century. All that the war had done