CHAPTER II

The Economics of Reparations

Under the London Payments Plan Germany had to pay reparations at a rate of slightly more than 3 billion gold marks annually. The fulfillment terms of the Versailles Treaty also imposed other charges. Through the Clearing Operation Germany had begun to pay another half-billion gold marks to Allied citizens on claims arising from the war.1 (Additionally, Germany owed payments on occupation costs that were accumulating at the rate of 1.5 billion gold marks annually, but the Allies, realizing they would have enough difficulty collecting the 3.5 billion gold marks in reparations and clearing payments, found it politic not to press the matter.)2 Germany's national income was about 35 billion gold marks in 1921.3 So stated, the problem was a simple exercise in the arith-

1 Germany was remitting about 40 million gold marks monthly. The payments totaled 615 million gold marks by August, 1922. A reminder: the gold mark-dollar rate was 4 to 1 (see Introduction, n. 12).
2 Weill-Raynal, Les réparations allemandes, 1:528-29. The Reparation Commission said Germany owed 3.6 billion gold marks to May 1, 1921. The Allies also did not insist on payment of the 360 million gold marks lent Germany under the Spa Agreement to buy food for her miners.
3 John Maynard Keynes gave this estimate for 1922. National income in 1913, according to Karl Helfferich, who was the generally accepted authority for the prewar period, was 43 billion marks. Keynes obtained his figures by assuming a 15 percent production loss from the 1913 level. Working back from the Keynes figure, one might guess at a figure closer to 30 billion gold marks for 1921, and
metric of economics: Germany was being fined 10 percent of her income. The penalty might cause some pain, but many nations—and individuals—have suffered greater privations at some time in the course of their lives. The national income of the United States, for example, fell by nearly half from 1929 to 1933. The economic problem was not that simple. Nor was the problem simply economic.

Still considered as an abstract exercise in economics, the problem becomes more difficult when other relevant economic components are inserted. In the fiscal year just ended when Joseph Wirth took office, April 1, 1920, to March 31, 1921, the German federal budget had a general operating deficit of the equivalent of 6 billion gold marks. The general operating deficit was in the process of being somewhat reduced, but it would still be very large in the period to come. The Wirth government had to deal with a crippling deficit while accepting the additional charge of 10 percent represented by the 3.5 billion gold marks in reparations and clearing payments.

The literature on reparations seldom mentions the general operating deficit. Normally, when a nation has to pay an external charge, the first question would be about the trade balance. A trade surplus, like an individual's excess of income over expenses, is the usual source for such a payment. The situation was grossly abnormal, a fact few persons completely appreciated at the time.

The general operating deficit compounded within itself the

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Rathenau himself used 30 billion as his estimate in a speech to the Reparations Committee of the National Economic Council on November 9, 1921. All figures, however, are gross approximations, and I prefer to use the higher estimate in order to avoid any possible exaggeration of German hardship. Keynes and Rathenau may have failed to appreciate the extent of productivity increases resulting from the war.

Most German statistical reviews avoid giving national income and many other important figures for the war and postwar periods—until 1924. The chaotic conditions, accompanied by inflation, made evaluation difficult. Moreover, national income accounting was at an earlier stage of development. I have selected figures which, while subject to a large margin of error, should give the approximate proportions of the German economic situation.

Germany, Statistisches Amt, Wirtschaft und Statistik (1924), vol. 9 of bound monthly bulletin, p. 276, table. The term general operating deficit is mine. The table simply shows the figure of 6 billion (actually 6,053.6 million) gold marks as the difference between government income and expenditures. Income was 3,178.1 million gold marks in taxes and 97 million gold marks in other receipts; expenditures were 9,328.7 million gold marks.

Or balance of payments. For this review the trade balance should suffice, since the difference between the two was both small and incalculable at this point in German economic history.
nation's various deficits, including the trade deficit. Through its budget the government was making up for all the deficits. Under the extraordinary war and postwar conditions, the German government, like the governments of the Allies, but more totally and baldly, had assumed responsibility for the economy. While the trade statistics are important, the general operating deficit remains the most relevant figure to be set beside the national income in judging Germany's situation.

For the sake of clarity it would be useful to examine the relationship between the general operating deficit and the government's budget. The government started the fiscal year on April 1 with a budget which conventionally provided for anticipated revenues and expenditures. At the end of the fiscal year the general operating deficit showed what had actually happened to revenues and expenditures. In the early postwar years of the Weimar Republic what had actually happened was radically different from what the budget promised. The budget was largely a fiction.

None of the Finance Ministers of the period were able to predict expenditures with any accuracy. Furthermore, none of them dared make realistic provision for many expenditures since this would have required a great increase in taxes. Some of the unexpected items were enormous. In the fiscal year 1920–21 the government had to pay the costs that resulted from right-wing and left-wing risings as well as arbitrary charges under the Versailles Treaty. Moreover, under its general responsibility for the economy, it was financing imports of food and other products defined as vital to the nation, giving subsidies to the states and communities, and compensating private citizens and companies for property and holdings confiscated by the Allies. Through disguised budgetary items it was also providing funds to irregular military units. The result of all this—and the trade deficit—was the global deficit figure of 6 billion gold marks.

The government financed the deficit by borrowing from the Reichsbank, the bank of issue. In effect, it borrowed from itself. It gave the bank treasury notes for the difference between income and expenditures. The Reichsbank discounted the treasury notes and in return gave marks to the government. The security of the

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6 The nation's floating debt was represented by these treasury notes. Thus the sum of the treasury notes gave the figure for the total debt at any given time. Since the debt was measured in increasingly inflated paper marks, the figure required
paper marks was only the promise to pay of a deficit-ridden government, and the currency lost value with every new economic difficulty and political crisis. By the end of the war the paper mark had lost half of its face value, going from 4 to 8 to the dollar. A year later it was quoted at 50 to the dollar, and it was at 65 when Wirth took office. The costs of the London Payments Plan and the uncertainties caused by the Upper Silesian problem drove the rate above 300 by November, 1921.

As Finance Minister of the old cabinet, Wirth himself had drawn up the budget for the fiscal year 1921–22. This was the budget with which he had to work as Chancellor and his own Finance Minister. It had failed to close a gap of 1.7 billion gold marks between expenditures of 4.7 billion gold marks and receipts of 3 billion gold marks. It had also failed to make any provision for the reparation and other payments to which Wirth had committed the government of fulfillment. The payments falling within the fiscal year would total about 2.5 billion gold marks of the 3.5 billion gold marks for a full year. Experience strongly suggested, however, that the size of the uncovered deficit was an excessively optimistic calculation.

The trade figures were also discouraging. In the calendar year 1920 there had been a modest deficit of 223.2 million gold marks...
on imports of 3,947.2 million gold marks and exports of 3,724 million gold marks. In 1921, although exports were rising, imports were increasing much faster, and Wirth had to struggle with a current trade deficit of more than 1 billion gold marks. The nation finished the year with imports of 5,750 million gold marks against exports of 4,587.4 million gold marks.8

Thus the Wirth-Rathenau government, promising to pay 2.5 billion gold marks to the Allies in the fiscal year 1921-22, found deficits where it needed to have income, 1.7 billion gold marks in its budgeted finances and more than 1 billion gold marks in foreign trade.

The character of the government's task could be illustrated by making alternatively false assumptions about the two deficits. Assume, first, that trade was balanced. To eliminate the government deficit and also pay reparations the government would be obliged very nearly to double taxes and halve expenditures. Assume, next, that the budget was balanced. To pay reparations the government would have to transform a trade deficit of 1 billion gold marks into a trade surplus of 2.5 billion gold marks. These considerations are based on more false assumptions, namely ceteris paribus. Budget improvements would have negative effects on trade, and a trade improvement could have been purchased only at the price of new deficit items in the budget. In any case the Allies were demanding drastic changes in the German economy, and drastic changes meant unprecedented problems. As John Maynard Keynes remarked about the German trade situation on another occasion: "At a given time the economic structure of a country, in relation to the economic structures of its neighbors, permits of a certain 'natural' level of exports, and ... arbitrarily to effect a material alteration of this level by deliberate devices is extremely difficult."9 A comparable alteration of the budget was no easier.

The mechanism of the London Payments Plan, furthermore,

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8 Germany, Statistisches Amt, Statistik des deutschen Reiches: Der auswärtige Handel in den Jahren 1920, 1921, und 1922 (1924), 310: sect. 1, 2, table. The 1921 export figure, again illustrating the statistical problems, is an estimate by the Statistisches Amt. More precise figures were lacking for the period of May to December because of breakdowns in reporting procedures.

would cancel a large part of the positive results from an export increase. According to the plan, Germany, besides remitting the base annual figure of 2 billion gold marks, also had to pay 26 percent of her export revenues to the Allies. In 1922, with exports at 6,206.7 million gold marks, this would have increased the variable part of the reparations total from 1 billion to 1.6 billion gold marks. The penalty came in addition to another factor—normal in this case—that necessarily reduced the advantage from exports. A highly industrialized country, Germany got much of her income by transforming imported raw materials into labor-intensive products. At least a third of her imports went directly back into her exports. Additionally, other imports were necessary to keep the economy operative. These included many items, anything from mining equipment to specialized textbooks, which Germany did not produce because of the international division of labor. (Germany also had to import food; during this period food accounted for 20 percent of total import value.)

Thus the 26-percent payment provision and the need to expand imports would cause her to lose a large part of the advantage from an export increase. An economist could set up the problem in this way: He might imagine Wirth holding imports in 1921 to 5 billion gold marks, instead of letting them rise to 5,750 million. According to the export-percentage provision, Wirth would then have had to increase exports to more than double. By raising them above 9 billion gold marks, Wirth could pay reparations of more than 4.3 billion gold marks (2 billion plus 26 percent of 9 billion gold marks) at that export level. This assumes that Wirth could have restricted all the imports necessary to keep the economy operative (and thus indirectly serving exports) to less than 1 billion gold marks; the other import expenditures would have been the 1.25 billion gold marks for food and 3 billion gold marks for raw materials directly serving export production (i.e., one third of 9 billion gold marks). The assumption is false, and the mathematics a fantasy. If the trade situation was bad enough, the London Payments Plan made matters exquisitely more difficult for a responsible German government.

The objection might be made that the possible sources of payment have been limited to current income items. In the analogous case of an individual with a large debt, this would mean that only

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10 Germany, Statistisches Amt, *Statistik des deutschen Reiches*, pp. 5–6, table.
his salary has been taken into account, although he would normally have possessions of considerable value. His house, for instance, could be mortgaged to pay the debt. Similarly, Germany had a large resource, its national wealth of 250 billion gold marks.\textsuperscript{11} The Allies had grave problems of their own, and it was conventional politics to make the loser pay the penalty for the war. Could Germany not use her national wealth to pay reparations?

At least three plans tried to exploit Germany’s national wealth. On May 19, 1921, Robert Schmidt, the Socialist Economics Minister, submitted a memorandum calling for the confiscation of 20 percent of the value of German private property.\textsuperscript{12} Another Schmidt conception, discussed by the cabinet on July 29, would capitalize company taxes for 40 years.\textsuperscript{13} Still another plan, drafted later that year in the National Economic Council, proposed to borrow against German property in foreign markets.\textsuperscript{14} But the sums promised were small. Schmidt’s first idea envisioned a billion, his second, perhaps 3 billion gold marks. The National Economic Council plan anticipated 2 billion. The reason lay in the character of a national economy. Most of the German national wealth was composed of a multiple of tiny units—retail stores, dwellings, peasant holdings, and the like—which were difficult to evaluate and impossible to translate into negotiable values. This left a comparatively small proportion, represented by such choice properties as major industrial firms, that was truly negotiable. As the three plans indicated, a fraction of this fraction produced insufficient returns. Furthermore, the existence and undisturbed operation of these firms was an important present strength—indeed, the best strength of the German economy. Foreign investors, attracted by the reputation of German industry, were presently sending considerable sums into Germany in the hope of future profits. The economy, thus, was receiving returns from its industry over and beyond its current production values. Another alternative would have been to take complete possession of the leading companies. This might have produced 25 or 50 billion gold marks, but here the problem

\textsuperscript{11} W. S. Woytinsky, \textit{Die Welt in Zahlen} (1925), 1:198.

\textsuperscript{12} Copy of the plan in Julius Hirsch, \textit{Die deutsche Währungsfrage} (1924), pp. 50–69; copy of the memorandum of May 19 and of another memorandum giving more details, this latter dated June 27, both in Ausführung, BA, R431/20.

\textsuperscript{13} Kabinettsprotokolle, BA, R431/1369.

\textsuperscript{14} Copy in Ausführung, BA, R431/26.
went beyond economics, as in the case of the exercise that would double taxes and halve expenditures, or the exercise that would double exports. The national wealth resisted extraordinary exploitation.

The problem of reparations tended everywhere to break out of the bounds of economics. At the cabinet meeting in July, Rathenau had argued that the second Schmidt plan—the tax capitalization idea—would cause political disunity and reduce the nation's productivity. It was a mildly expressed objection to a modest plan that Rathenau did not take seriously. But a large effort, whether affecting current revenues or the national wealth, would have required profound changes of structure as well as great sacrifices. It would have meant a revolution. The Allies did not want a German revolution.

The word revolution is not used lightly. It means violence and repression. The major economic, political, and social groups would have resented the great sacrifices demanded of them. Businessmen and employers would have tried to pass the extra costs on to the consumers and employees. The workers, for their part, would have resisted, and their resistance would have been violent. Many of them were still hungry and cold. The Independent Social Democrats and the Communists would have had the issue they were seeking. There would have been strikes, demonstrations, and other overt action. The government would have had to resort to repression. Only a police state could conceivably have given the Allies the quantities of German wealth they were demanding. The Allies, when they realized it, would find the price too high.

These were the possibilities of payment from the only two sources—current revenues and national wealth.

This view has been restricted to the problem of producing extra values. The consumption of those extra values was no less difficult. The economist R. F. Harrod speculated on what would happen: "Britain and France would be living the life of lotus eaters, with taxation low, hours of work light, their markets gone, enjoying the well-earned fruits of victory over a period of thirty or forty years. Was it not obvious that, if this were actually to happen, at the end of the period France and Britain would be totally at the mercy of Germany?" Harrod might have pointed to the experience of sixteenth-century Spain with silver from the New World.

Harrod was discussing the transfer problem—the problem of transferring wealth over national frontiers. It was the transfer problem that set the final limits on Germany's efforts to pay reparations.

In Harrod's consideration of the transfer problem he was thinking of an export surplus—current revenues—as the only conceivable possibility for paying reparations. Thus he ignored Germany's national wealth as a potential source. Since this was a real question, it might be looked into before his reasoning is pursued further. The two Schmidt plans and the National Economic Council plan, all trying to exploit the national wealth, envisaged something like mortgage certificates representing that part of the private property confiscated by the German government. These certificates would have been sold on foreign exchanges to produce the money for reparation payments. Any plan would have failed at this point. Foreign businessmen would have resisted the additional competition for the investment money available to their countries. Their opposition would have forced their governments to take prohibitive or restrictive action. In any case, the mortgage certificates could not have attracted investors unless they paid premiums so large as to defeat the sense of the operation. The difficulty could have been overcome by Allied guarantees of the German paper or the solvency of the German economy itself. No Allied government would have been so incautious. On April 27, 1921, the British cabinet discussed accepting shares in German industry. It was objected that such a plan "might lead to speculation and give German industry a preference over Great Britain's" besides also giving "foreign countries an interest in German domestic affairs." The question was never raised again.

Harrod was willing to imagine the Allied populations living upon the comforts provided by free German exports. He imagined it to refute it. He was illustrating the falsity of the assumption that the Allied economies would make the adjustments necessary to receive the import surplus—that is, reduce their production in the articles that Germany manufactured. The Allies would have had to match the German revolution with one of their own. Indeed, the distortions in the German economy of 1921 clearly indicated what would happen. The inflation was enabling German exporters to undersell

foreign producers in their home markets. Great Britain was suffering from unemployment and a trade deficit made worse by the import of cheap German goods, and its businessmen were demanding protection. During 1922 both Great Britain and the United States raised their tariffs. In France the Chamber of Commerce of Nancy, reacting to the threat of German reparation deliveries of goods, protested: "It would be useless to revive our shattered industries, if German competition would simply destroy them all over again." In an interview in April, 1921, John Foster Dulles defended his advocacy of a large reparation sum at the Peace Conference two years before: "A hard-working and intelligent population of sixty million with a magnificent industrial plant can . . . perform wonders." Dulles now recognized a difficulty that transcended his logic: "But the capacity to pay is meaningless when there is no comparable capacity and will to receive." The Allies were demanding reparations while refusing to permit the Germans to earn the revenues with which to pay reparations.

Many persons tried to solve the general problem of reparations with or without regard to its transfer aspect. Nearly all of them used irrelevant or incomplete statistics, or words as substitutes for the ineffable figures. A typical discussion of the German deficit would urge economy but fail to give figures showing how much

17 Inflation does not necessarily give the advantage to the exporters, but it did in the case of Germany at this time. The point was that the German currency was undervalued on the foreign exchanges. As a result, a foreigner buying cheap marks could get German goods for bargain prices.
18 Quoted in article of October 29, 1921, issue of trade publication, L'Usine. The article was one of a series collected in the pamphlet, Un danger national (Paris, 1921), quotation on p. 70. A copy of the pamphlet is in the archives of the Wiederaufbauministerium, BA, R38/159.
19 Published in Neue Zürcher Zeitung, April 27, 1921; copy in Wiederaufbau­ministerium, BA, R38/157.
20 The problem-solvers included heads of governments and their experts, businessmen and trade union leaders, French nationalists and Socialists, German internationalists, the leader of a German women's organization and the German manager of an American country club, the Alsatian-Jewish publisher of a French provincial newspaper, a Bordeaux law professor, a Scottish Labor member of Parliament, an American state governor, a Krupp salesman in Budapest, members and former members of the Reparation Commission, and economists. A number of their plans were listed and analyzed in a German government memorandum. An unsigned copy, with no indication of source, is in the Ausführung file, BA, R43/1/33. Many other plans are scattered throughout the government's archives as well as the whole literature on reparations. Some persons, like the country club manager and the Krupp salesman, thrust their plans directly upon the Chancellor.
could actually be saved. A typical discussion of foreign trade would demand the forcing of exports but would fail to specify the income reasonably to be expected or to admit the negative effects. An expert once employed in the French section of the Reparation Commission did use figures in a series of tables that produced substantial reparation sums. For the beginning year he got 4.1 billion gold marks by putting exports at 7.5 billion gold marks and imports at 4.4 billion gold marks, and requiring the cession of 1 billion gold marks of capital. For a later year he projected exports of 11 billion gold marks. He did not explain how this would come to pass and he admitted that he had made no provision for protectionist action by recipient countries.\textsuperscript{21} Another idea did concede the possibility of Allied resistance to German trade. Its solution was to channel the trade to "third countries," but these were not identified, nor were figures given for their capacity to absorb additional products. In a book published in the United States in 1921, André Tardieu pointed out that Germany in 1913 had a production excess of 8.3 billion gold marks over consumption which it used for reinvestment. A sum of that size, he said, should be made available for reparations.\textsuperscript{22} He ignored the fact that a modern economy cannot survive without continuing investment, nor did he inquire how the money would be transferred. But by 1921 most of the plans tended to make reparations disappear at least partially by means of reductions, moratoriums, and loans. Lloyd George soon was giving evidence of doubt about his London Payments Plan. Even a few French opinions indicated a willingness to settle for less, although this was often associated with the idea of compensation in the form of control of German territory or industry. In late 1922 the former president of the Reparation Commission, who was French, saw no alternative but reduction.\textsuperscript{23} Some persons, obviously in the hope of easing the conditions, suggested another agency, the League of Nations, an international court, or an international financial commission, to determine and administer reparations. None of the plans could overcome the transfer problem.\textsuperscript{24}


\textsuperscript{22} André Tardieu, \textit{The Truth about the Treaty} (1921), pp. 326–44.

\textsuperscript{23} Preface by Louis Dubois to pamphlet by Frédéric Jenny, \textit{La capacité et les moyens de payement de l'Allemagne} (1922).

\textsuperscript{24} Actually, as Keynes pointed out, there were two transfer problems. The second one, however, never got the chance to become operative, because the
The best known private effort to solve the reparation problem was the plan given in Keynes's *Economic Consequences of the Peace.* Like Rathenau, Keynes had wanted to see the cancellation of the United States war debts. There was, however, an important distinction in the character of the two proposals. Rathenau's plan was offered for serious political action at the London Conference. Keynes had resigned as British Treasury representative at the Peace Conference because he knew he could not influence immediate political action. Not obliged to suggest what might be acceptable at the moment, he chose instead to write a book that might have its effect by changing public opinion. Nevertheless, he did compromise with the political realities. At the time—he wrote the book in the autumn of 1919, "at the dead season of our fortunes"—he wanted to limit cash reparations to 30 billion gold marks, after crediting Germany with 10 billion gold marks for confiscated material and property. He had little fondness for even that figure. He tried to compensate for it by advocating an international loan fund of $1 billion and also a "guarantee" fund of another billion, to be financed chiefly by the United States and Great Britain, which would directly or indirectly ease Germany's position. He also suggested that payments be adjusted to Germany's capacity to pay, as determined by a reparation commission on which neutrals and the Germans themselves would be represented. The Keynes ideal solution was given two years later in a phrase in his *Revision of the Treaty:*

Allies failed to provide the conditions for solving the first one. The Keynes comments on Germany's export difficulties, quoted earlier in this chapter, were part of a general review of "The German Transfer Problem" (n. 9) at a time when a prosperous but apprehensive Germany was facing the final payments plan under the Versailles Treaty. Keynes wrote: "The expenditure of the German people must be reduced, not only by the amount of the reparation-taxes which they must pay out of their earnings, but also by a reduction in the gold-rate of earnings below what they would otherwise be. That is to say, there are two problems, and not—as those maintain who belittle the difficulties of transfer—one problem" ("German Transfer Problem," p. 4). This could be applied to the situation facing Wirth in the spring of 1921. At the time, the figures showed that he had to increase exports by 5 billion gold marks in order to achieve a trade balance and pay reparations beyond that. Keynes is saying, however, that Germany would have had to sell at a discount to undersell competition and attract new customers. Thus she would have had to deliver perhaps 6 billion gold marks of goods and services for the 5 billion gold marks of revenues she could have hoped to realize.


Ibid., p. 297.

"The cancellation, in part or in their entirety, of . . . reparations and inter-Allied debts." He preferred the unqualified cancellation. It would have solved the transfer problem by eliminating it.

Another effort to solve the transfer problem deserves attention because of its ambition and circumstances. It appeared in the book, *The Carthaginian Peace or the Economic Consequences of Mr. Keynes.* The young French author, Étienne Mantoux, wrote the book in the United States during World War II and then died in action while serving with the French forces. Mantoux argued that other international transfers of wealth showed that a reparation transfer had been possible. He gave as examples the transfer of great sums among the Allies in World War I and the American use of the Lend-Lease system in World War II. Both cases, however, disprove his point. The source of both transfers (after the British and French reserves were exhausted) was the American economy, with its great reserves of productive capacity. Most of the inter-Allied debts were not repaid, and the purpose of Lend-Lease was actually to eliminate money payments by Great Britain. A later French student of the problem, who also believed in Germany's capacity to pay, found the Mantoux arguments untenable. He fell back on the compounding of deliveries in kind and gold and stock transfers, but he gave no figures. He had made the full circle and arrived back in 1921 with its arguments.

In view of all the difficulties, why did the Allies expend so much energy in attempting to collect reparations?

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28 P. 183. He had already called for the cancellation of the inter-Allied debts in *Economic Consequences*.

29 Étienne Mantoux, *The Carthaginian Peace or the Economic Consequences of Mr. Keynes* (1946).

30 *Ibid.*, pp. 117–32. On p. 132: "The Lease-Lend [sic] system is . . . the best possible demonstration of the insignificance of the transfer problem . . . ." Mantoux avoided another example of the transfer process which had been often mentioned. "The Franco-Prussian indemnity of 1871 led economics into a great deal of trouble because it created a precedent for German reparations after World War I when the conditions basic to the payment were altogether different" (Charles P. Kindleberger in his textbook *International Economics* [1963], p. 373). He pointed out that the French government had available to it sufficient foreign exchange to pay the indemnity of 5 billion francs (the gold equivalent of 4 billion gold marks, incomparably smaller than German World War I reparations) without difficulty.

The ultimate responsibility was American. The United States had forced the reparation policy on the Allies by demanding repayment of $11 billion in war loans. Great Britain, which had loaned out nearly $8 billion to her allies, including $2 billion to France, owed $4.3 billion to the United States; France owed $3.4 billion. The Allied statesmen did not see how they could get the money out of their war-weakened economies, which were burdened also with great internal debts. Their only resource, whether real or imaginary, was the reparation claim on Germany.

The importance of the war debts had not been clear at the opening of the Peace Conference in January, 1919. The simple violence of the feelings of the Allied populations was more important: let the Germans pay. An awareness of the economic data, however, had restrained the conference leaders. It had been politically safer not to resolve the differences, but to pass the reparation problem on to the Reparation Commission. The legal claim might be pressed when time had had a chance to alter the situation.

By 1921 the situation had indeed changed. The American position on war debts had become clearer, if the Europeans were willing to believe their eyes. The Congress, increasingly irritated at the executive's slowness in impelling the Allies to pay, was debating legislation, which it would pass in early 1922, creating a commission under its control to assure payment. The British electorate was beginning to relent on reparations. The London Conference gave its emotions a final release, and it could begin to turn away from such an unproductive issue. Becoming more realistic about reparations, the British remained hopeful about making an arrangement on the war debts. The French, with their devastated areas, had a livelier memory of the war, and a more obvious use for the reparation money. Threatened now by American claims, they had the feeling that they were being swindled and they angrily pressed their government to make the promises real. The contradictions had altered in shape but not in character and depth.

The difficulties had been worsened by a great failure in economic thinking. A world economic revolution, greatly accelerated by the war, had occurred, but few persons could appreciate its extent. The new importance of government in the economy, the development of trusts, the increased economic power of the United States, the Soviet experiment, and the huge debt and deficit figures were all expressions of it. Laymen had no equipment with which to make
judgments, but the experts suffered from their training. Denying what they saw, the experts continued to apply the doctrines of classical economics. They went on recommending the expeditious payment of debts and the balancing of budgets, no matter how huge the figures were. They refused to admit the difference in kind between a national debt that was 20 percent of annual national income, compared with one that was 150 percent of income. Yet, if they were optimistic about the speed with which the debts could be reduced or eliminated, they were pessimistic about the capacity of the world to produce new wealth. They had failed to credit the great increase in industrial productivity. They did not see that the world could carry much greater debts for a much longer time without violating sound financial principles. In the name of sound financial principles the experts were recommending self-maiming.

The United States embodied the greater magnitudes of the world economic revolution. It was producing and consuming at least two-fifths of the world’s industrial goods. While the war had impoverished Great Britain and France, it had made the United States richer. Nevertheless, America maintained its traditional protectionist policy. With tariffs about 30 percent ad valorem, it had a trade surplus of $4 billion in 1920 and $3 billion in 1921. Great Britain had a trade deficit of $2 billion in 1920 and $1.4 billion in 1921. The German transfer problem was only part of a greater world problem. Due to American policies and the dominant deflationary bias of its economic thinking, Great Britain was enduring a high rate of unemployment, which averaged more than 10 percent from 1921 to 1939. In 1921, while trying to make decisions on reparations, the British cabinet was being increasingly distracted by the need to do something about the unemployment problem. The United States, failing to appreciate its great resources, was unhappy to compare a national debt of $25.5 billion in 1919 with the $1 billion of the prewar years. Great Britain, whose national income was

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32 League of Nations, Secretariat: Economic, Financial and Transit Department, Industrialization and Foreign Trade (1945), p. 12, diagram no. 1, "Movement of Manufacturing Production." For 1921 the diagram shows the U.S. with 40–45 percent of world production, compared with Germany, 11 percent; United Kingdom, 10.5 percent; France, 8 percent; and Italy, 3.5 percent.

33 Cabinet discussions on February 11, 1921, and throughout April and May, at some length on May 26, Cabinet Conclusions, PRO, CAB 23/24 and CAB 23/25. A cabinet committee and a Treasury committee thereupon studied the problem, the cabinet discussing their reports on October 6, and considering a public works plan on October 14, in ibid., CAB 23/27.
a third of America's, had a national debt of $35.6 billion at the war's end. France had a national debt of $22.2 billion. After World War II the United States gave and did not demand money. Only Keynes had imagined such a policy in 1919, and he expressed it in the modest form of international loan and guarantee funds. Thrown back on their resources, the Europeans improvised with expedients and factitious solutions. The French government, for example, had not dared to reduce expenses and increase taxes enough to balance its budget, as the financially more responsible British cabinet had done. The 1921 French budget foresaw revenues of 23.1 billion francs and expenditures of 43.8 billion francs, for a deficit equivalent to $1.6 billion or 6 billion gold marks. The deficit was carried in the budget under the heading, “Recoverable Expenditures,” and a League of Nations statistical reporting service explained: “The budget of recoverable expenditures is mainly covered by loans in anticipation of reparations payments.”

The American war-debt policy pierced through the Allied economies to strike at the German economy.

The London Payments Plan established the connection. Its announced figure of 132 billion gold marks in reparations was a gesture toward the angry Allied citizen. The Allied statesmen were serious only when they got to the figure of 50 billion gold marks, the principal on which the installments were calculated. This part of the debt was only slightly more than the $11 billion war-debt total.

On January 20, 1921, when Aristide Briand introduced his new cabinet, he told the Chamber of Deputies: “If there is a question of bankruptcy . . . , if someone has to arrive at such an extremity, it would be scandalous if it were not Germany.” It was the most reasonable kind of insanity: let the other nation go under first. It was the only policy, even if your country was inextricably bound to the other and its fate. Your country would, at least, have the advantage of some fragments of time over the other nation. The Allies were all agreed on this, although they might quarrel about the details—and about the second bankrupt.

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