

referred to in letter of 9/27/27  
S. Parker Gilbert to Gov. Strong

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NOTE ON THE ORIGIN OF THE GOLD DISCOUNT BANK AND  
ITS STATUS WITH RESPECT TO THE REICHSBANK LAW AND  
THE EXPERTS' PLAN.

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The following note on the origin of the Gold Discount Bank and its legal status with respect to the Reichsbank Law and the Experts' Plan examines these questions with particular reference to the subject of the liquidation of the Gold Discount Bank and to the legal propriety of the employment of the Gold Discount Bank by the Reichsbank for the accomplishment of purposes which are either prohibited to the Reichsbank by the Bank Law of August 30, 1924, or at least unauthorized by that Law.

The reasons for the creation of the Gold Discount Bank can be most easily stated in Dr. Schacht's own words. He made an explanatory declaration before the Budget Commission of the Reichstag on March 8, 1924, and he made a public declaration in an address at Koenigsberg on February 8, 1924, at the time of the Agricultural Fair. The first excerpt is taken from Dr. Schacht's statements to the Reichstag Committee, as translated by the Committee of Guarantees.--

"As soon as I was appointed President of the Reichsbank, I went to London to start negotiations with a view to carrying out a scheme which I had had at heart for a long time, and which was founded on the following basis:

"We have a paper currency in Germany which has been reduced by inflation to almost nothing. We have stabilised it to a certain degree by issuing the Rentenmark. The latter is essentially a currency founded on credit, and cannot therefore be used in quantities susceptible of being increased arbitrarily. Only sufficient Rentenmarks to cover industrial requirements can therefore be put into circulation. In consequence



deplorable state of poverty in which Germany is at present, we are also suffering from a shortage of capital and of credits, which must absolutely be remedied if we wish to restore our economic prosperity. On the other hand, the reconstitution of a real gold-currency in Germany is naturally impracticable, until the complicated series of big questions connected with the reparation problem are solved. In my scheme, I never dreamt of giving Germany a gold-currency created out of her own resources, until all the complicated political problems were settled. My sole object was always to attract gold-capital from abroad, or to borrow it from sources which have not yet been tapped, in order to benefit the German industry. I considered that this appeal for foreign capital would be more likely to succeed if it were suggested to create a bank, and I may recall the fact that up to the present all attempts made in order to attract foreign capital to Germany for the use of our industry have failed, with the exception of private credits received from abroad. ....

"On the other hand, I consider that, by adopting the form of a bank, the gold-capital of which would be safely deposited abroad, and thus sheltered from all risks, it might be possible to attract this capital, which could then be employed for financing German industries. I opened negotiations with the Bank of England on January 1, and then had a whole series of conversations with City men; they all gave me the impression that the City of London was willing to help us to carry out the scheme I had brought before them. It was during these conversations that the Committee of Experts was appointed, and began to discuss these questions at Paris in the middle of January. ....

"Naturally, the ideas of the Committee of Experts differed widely from my own. The experts wished to create a final gold-currency in Germany, in order to establish, on the basis of a sound currency, the reparation payments which would have to be made by Germany. .... Imbued with these principles, when the experts discussed my proposal, they always showed anxiety that it might injure or block their own proposals. I endeavoured to convince them that this would not be so, the negotiations on this point dragged on, as you know, for several weeks, and ended in a series of stipulations of which I will give you a brief summary.

"The principal purpose of these stipulations was to limit the numerical importance of the Gold Discount Bank; the capital is to be limited to 200 million gold-marks, and the right to issue banknotes to 100 million marks. I claimed the right for this bank to issue notes for reasons which I shall



explain later. Out of this capital of 200 million gold marks the Reichsbank was itself to supply 100 millions, and would buy a share in the remaining 100 millions, so as to secure a majority of the capital so long as the Gold Discount Bank existed. The statutes would provide that this majority should confer the right to liquidate the bank, so that the Reichsbank would be entitled to liquidate the Gold Discount Bank at any moment it pleased. It is also provided that, in case of liquidation, the capital would be restored to the shareholders under the conditions given above. It was finally decided, in the form of a simple option, that, if a final monetary organisation were to be created with the participation of the Reichsbank, or by the Reichsbank, or in any other form whatsoever, the shareholders of the Gold Discount Bank would have the right to purchase shares at par in the final monetary bank, so that they would not suffer by the liquidation, but could share once more in the undertaking. Another condition is that this bank will remain free from all political influence, and that it will naturally be prohibited to issue or redeem Loans issued by the Commonwealth, the States or the Communes\*.

Exactly a month earlier Dr. Schacht expressed himself at the Koenigsberg Fair in part as follows :-

"I have been fighting for many months in favour of the creation of a gold bank which must naturally be closely connected with the Reichsbank and the Rentenbank, as we must centralise our gold policy in one spot.\* \* \* \* It was whilst I was in the midst of this work that I was called to Paris by the Committee of Experts. I set forth my ideas to this Committee. On the one hand I met with lively approval, on the other, I was informed that it would not suffice to create a gold-bank which would answer to present circumstances, but that a definite gold-currency should be created in Germany. I replied to these gentlemen as follows: in principle I agree with you in recognising that we should create this gold-currency in Germany. I should gladly hear that you were willing to help us to achieve this result. I am also willing to believe that in the course of the next few weeks, you will come to a unanimous agreement on this point in the report you will submit to the Reparation Commission. But it remains to be seen what results will be obtained from your report. According to our experience up to the present with regard to nearly all the reparation negotiations, I am authorised to believe that not only weeks, but months will elapse before your report will result in a unanimous decision being adopted by the Allied and Associated Governments. We cannot afford to wait so long.\* \* \* \* I hope they (the Experts) will be reasonable



enough not to thwart our efforts to create a gold-note bank, which will provide us with an instrument making it possible for us to recover and to work".

The foregoing public declaration by Dr. Schacht, at a time when the Experts' Committee was still working, in executive sessions, upon the formulation of the Plan, which was submitted to the Reparation Commission some two months later, obliged the Experts then sitting in Berlin, to make some open statement on the important proposal announced by the President of the then Reichsbank. Almost immediately, on February 10, 1924, a communiqué was given to the Press by the Committee. According to Rufus C. Dawes (The Dawes Plan in the Making, p. 207), this statement was approved before publication by "Dr. Schacht after conference with the heads of the German Government". The communiqué reads :-

"The work of the First Expert Committee has enabled it unanimously to lay down the broad lines which it will recommend for the establishment of a new German bank of issue on a gold basis, which will exchange its own notes against those of the Rentenbank and the Reichsbank.

"The general principles of this plan have been communicated to Doctor Schacht, who is very clearly of the impression, shared by all the Experts themselves, that if it is put into execution it will prove to be the most important step towards the definite stabilisation of the German exchange and the balancing of the budget.

"The Expert Committee will inform the Reparation Commission that in its opinion the plan which the Committee will submit should be put into prompt operation.

"Doctor Schacht has informed the Committee that, in making his plan for the formation of his gold bank, he is so arranging matters as to facilitate its absorption by the bank of issue, which will be proposed by the Committee.

"The Expert Committee will meet Doctor Schacht on the eighteenth inst. at Paris."

On March 19, 1924, the Reichstag adopted two laws, the one amending the old Reichsbank Law by enabling that Bank to acquire shares of the German Gold Discount Bank and by extending the then



existing powers of the old Reichsbank as follows :-

"Article 2. The Reichsbank is entitled and required to carry out all transactions of the German Gold Discount Bank for account of the latter. The President and Members of the Board of Directors of the Reichsbank are empowered to belong to the Managing Board and any other administrative or controlling organisations of the German Gold Discount Bank; Article 16 of the Law relating to officials of the Reich (Reichsbeamten-gesetz) is not applicable.

Article 3. The Reichsbank is authorised, in the event of its taking over (Übernahme) the German Discount Bank, to raise its capital in proportion."

The second law adopted on the same date provided for the establishment of the Gold Discount Bank, and the following extracts from the Law are material to the present discussion:

"Article 1. Under the name "Deutsche Golddiskontbank" (German Gold Discount Bank) a Bank has been set up under the direction of the Reichsbank with private capital. The Bank is independent of the Government of the Reich. It has authority to issue pound sterling notes up to a total amount of five million pounds sterling. The notes are not legal currency.

\* \* \* \* \* The Statutes are drawn up by the founders, and will be published in due course.

For the period during which the German Gold Discount Bank has the right to issue notes, the same right may not be accorded to Banks which have no right of issue at the time of the coming into force of the present Law. This provision becomes invalid from the moment of the commencement of the liquidation of the Gold Discount Bank. \* \* \* \* \*

Article 5. \* \* \* \* \*

The Reichsbank has the right to liquidate the German Gold Discount Bank at any time, with the consent of the General Meeting of the German Gold Discount Bank.

\* \* \* \* \*

Article 10. The business management and the liquidation of the German Gold Discount Bank are effected exclusively through the Reichsbank".

The Statutes of the Bank, agreed on April 7, 1924, were published in the Reichsanzeiger of April 11, 1924, and the announcement was made that the Bank would commence business on Wednesday, the 16th of April, 1924. The pertinent articles of the Statutes



may be quoted as follows :-

"Article 1. The "German Gold Discount Bank" was founded in conformity with the Law of the Reich of 19 March 1924, for the purpose of satisfying the justifiable credit requirements of Germany, by means of the participation of home and foreign capital and credits and of all the German reserves of gold at disposal, making use of the privilege accorded to it to issue bank notes.

Article 2. \* \* \* \* \*

The object of the enterprise is the transacting of banking business and the issue of bank notes (see Article 1 of the Law)

\* \* \* \* \*

#### V. LIQUIDATION OF THE BANK.

Article 23. In the case of liquidation, the total capital of the Gold Discount Bank together with the accumulated reserves will be distributed amongst the shareholders in proportion to the amounts paid in by them on account of shares. For that part of the business year which has elapsed by the date on which liquidation begins, a special dividend shall be paid in accordance with a balance sheet to be drawn up the day before the Bank is liquidated.

Article 24. When the process of liquidation is complete, the books and papers of the Bank thus liquidated shall be deposited with the Reichsbank. The latter is also authorised to re-appoint the original liquidators or to appoint fresh liquidators, should capital be discovered which is subject to distribution."

On April 9, 1924, the First Committee of Experts presented its Report to the Reparation Commission. At that time, a week before the Gold Discount Bank opened its doors, the Experts expressed themselves as follows:

"The Interim Bank, - While coming to this conclusion and while reducing the general plan to details, the Committee had to deal with an actual change in the situation as it originally presented itself. The Committee were informed that a scheme for a gold bank was in preparation. It was expressly and admittedly limited to providing the means of carrying on foreign trade. When first submitted it contained some features which the Committee would not have recommended, and it omitted others which seemed to the Committee to be essential to any permanent settlement of the problem as a whole.



Moreover, an attempt to settle particular difficulties in isolation and without reference to other essential requirements appeared to the Committee to involve certain risks.

The Committee therefore without expressing any opinion on the plan as given to them in outline, assured themselves in consultation with the authorities responsible for Germany's monetary policy that the bank would be so organized as to facilitate its absorption into a new bank of issue which might be set up in accordance with the recommendations of the Committee."

Attention is called to the title "The Interim Bank" and to the fact that there was nothing in the Law or the Statutes relative to the Gold Discount Bank to justify the statement of the Experts that the Bank was expressly limited to providing a means of carrying on foreign trade. It is true that in the Reichstag discussions in connection with the passage of the Act paramount importance was given to this phase of the Bank's immediate work but in the text of the Law and the Statutes no such limitation was included. Annex I to the Experts' Report, which gives the Plan for the Organisation of a Bank of Issue in Germany, does not mention the Gold Discount Bank which, indeed, was not in being at the time of the drafting of this Annex. However, an Organisation Committee was provided for with wide powers to frame the corporate organisation of the New Bank and to prepare a proposed New Bank Law, new Bank Statutes and other legislation which should effectuate the general scheme and purposes of the Experts. Dr. Schacht and Sir Robert Kindersley were designated as members of this Committee.

Under date of July 11, 1924, the Organizing Committee addressed to the Reparation Commission, with covering reports,



proposed laws and statutes relative to the Bank of Issue, the Rentenbank notes and the metal coinage. The covering report on the Bank Law referred to a deviation from the original plan of the Experts as regards the issue of capital stock (which had been limited to issue against payment in gold and/or foreign bills, or in exchange for the shares of the old Reichsbank) in the following terms;

"A letter is attached hereto signed by the President of the Bank and a member of the Reichsbank Direktorium undertaking to do what is necessary to exchange the shares of the Gold Discount Bank for shares of the Reichsbank and to proceed with the liquidation of the Gold Discount Bank."

The letter attached read in the material part:-

"REICHSBANK-DIREKTORIUM

34/36 Jägerstr., Berlin SW 19.  
7th July, 1924.

To the Organisation Committee for the Bank;  
Sir Robert Kindersley.  
Dr. Hjalmar Schacht.

We hereby beg to state that after the re-organisation of the Reichsbank in accordance with the Dawes plan we shall take all necessary steps to acquire all the shares of the German Gold-Discount Bank by exchanging them against new Reichsbank-shares and to liquidate all transactions of the Gold-Discount Bank.

.....

Reichsbank-Direktorium.  
Signed: Hjalmar Schacht.  
Bocke."

Particular attention is directed to the terms of the foregoing letter of July 7, 1924, and to the language of the report of July 11, 1924 because, on the subject of liquidation, they are deemed to be of cardinal importance.

In the draft Bank Law annexed to the covering report, and later voted by the Reichstag, no mention is made of the liquidation



of the Gold Discount Bank or to the nature of its future activities, if any. But the right of the Gold Discount Bank to issue notes is specifically rescinded. The three references in the Bank Law to the Gold Discount Bank are next quoted :

"Article 2. \* \* \* \* \*

The right of the "Gold Discount Bank" to issue notes is rescinded. The notes in circulation on the coming into force of this Law have to be called in and withdrawn. The Managing Board of the "Gold Discount Bank" shall frame the detailed rules relating to this matter".

"Article 5. \* \* \* \* \*

The subscriptions to the new shares (i.e. of the new Reichsbank) must be made in the form of gold or foreign bills at their current gold values - except such shares as may be given in exchange for the existing shares of the Reichsbank, or the shares of the "Gold Discount Bank".

"Article 53. Subject to the provisions contained in § 52 above the Bank Law of the 14th March 1875 and the Laws amending the same shall cease to be in force except the Law of the 19th March 1924 \*

(Reichsgesetzblatt II, page 73). At the same time the provisions of the Rentenbank Ordinance of the 15th October 1923 (Reichsgesetzblatt I, page 963) and of the Law relating to the German Gold Discount Bank of the 19th March 1924 \* (Reichsgesetzblatt II, page 71) shall cease to be in force in so far as they are in contradiction with this Law".

Taking these few provisions of the Bank Law in entire isolation, it is clear not only that there is here no provision looking toward the early termination of the Gold Discount Bank but, on the contrary, that there is a stipulation which implies that this Bank may be continued. Whereas the Laws relative to the old Reichsbank "cease to be in force" (with the inevitable consequence that the old Bank ipso facto dies) the two Laws relative to the Gold Discount Bank are specifically maintained except in so far as they are in contradiction with the Law of August 30, 1924. While the provisions relative to the acquisition of the shares of the Gold Discount Bank by the Reichsbank tend in the direction of an

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\* Quoted in part on page 5 of this memorandum.



anticipated merger of the smaller institution with the larger, these provisions in and of themselves are not incompatible with the possibility that the new Bank was merely to acquire all the shares of the Gold Discount Bank, whose corporate existence as a subsidiary would be continued despite the fact that its power to issue currency notes had been terminated.

But the provisions of the Bank Law, although controlling in case of conflict, cannot be considered in entire isolation from the Report of the Organising Committee, or from the Report of the Experts, or from the general historical circumstances attendant upon the enactment by the Reichstag of this domestic legislation which had an international character and purpose. Was any engagement taken with regard to the future of the Gold Discount Bank which was not incorporated in terms in the text of the Law but which is nevertheless effective? The Law must be read and interpreted in the light of the other collateral documents and above all in the light of the Report of the Organizing Committee which was submitted to the Reparation Commission before it approved the Bank Law, and to the Reichstag when it voted the Bank Law. Both parties must, reasonably, be deemed to have considered that the passage of the Law would accomplish what the covering report said it was aimed to do. To repeat, however, if a specific provision of the Bank Law, as enacted, is irreconcilable with a concrete provision of the covering report, or of the Experts' Plan, or of an anterior collateral engagement, it is the final instrument, the Bank Law, which prevails. But where there is no incompatibility in the provisions



of the Bank Law with the engagements and provisions of the collateral documents in pari materia, both the Law and the attendant engagements are to be given force and effect.

This brings us back to the quotations from the covering report of July 11, 1924, and the letter from the Reichsbank of July 7, 1924, which are quoted on page 7 above, and to the true construction of their language. The letter from the Reichsbank speaks only, with respect to the question of liquidation, of acquiring "all the shares of the German Gold Discount Bank" and of taking all necessary steps "to liquidate all transactions of the Gold Discount Bank". A normal interpretation of this letter would lead to the conclusion that it was an undertaking to wind up the affairs of the Gold Discount Bank, unless the letter is to be given the extraordinary meaning that as soon as all the transactions of the Gold Discount Bank were liquidated then a series of new transactions would, or could, be commenced. This normal interpretation of the letter is in conformity with the statement of the Experts in their communiqué of February 10, 1924, said to have been approved by Dr. Schacht, to the effect that the Gold Discount Bank would be absorbed in the new Bank and is also in harmony with the unusual number of provisions relative to the mode and manner of liquidating the Gold Discount Bank which were inserted in the Law and Statutes relative to the Gold Discount Bank, and in further harmony with the passage in the Report of the Experts concerning the absorption of the "interim" bank. Furthermore, that the Organising Committee understood the letter of the Reichsbank to contain a promise to



liquidate the Gold Discount Bank and not merely its current transactions, is established by the language of the Report of the Organizing Committee which gives a contemporaneous interpretation of the representation of the Reichsbank in the following terms: "to do what is necessary to exchange the shares of the Gold Discount Bank for shares of the Reichsbank and to proceed with the liquidation of the Gold Discount Bank." This interpretation loses nothing of its value by the fact that it is signed by Dr. Schacht, the first of the two signatories of the letter of July 7, 1924. And it was this joint interpretation which was submitted to the Reparation Commission, acting for the Allies, when the Reparation Commission was asked to approve the Bank Law and attendant documents as carrying out adequately the recommendations of the Experts' Committee.

In this connection it is to be remembered that the arrangements relative to the Bank Law and other laws for the carrying into effect of the Experts' Plan represent an agreement between the German on the one hand and the Reparation Commission, acting for the Allied Powers, on the other. It is a matter of elementary jurisprudence that if before an agreement is reached one of the parties to the agreement communicates to the other his interpretation of a provision in the proposed agreement, and the other party subsequently, without objecting to that interpretation, executes the proposed agreement, the second party is thereafter estopped from denying that the language of the agreement has the meaning which the first party placed on it and communicated to the second party before final acceptance. In the instant case, before the



provisions concerning the Bank Law and its relation to German banking and currency provisions was approved by the Reparation Commission and communicated to Germany, and before the Law was enacted by the Reichstag, everyone was put on notice that it was understood on the Allied side that the Law was so drafted as to permit the liquidation of the Gold Discount Bank and that, further the Allies construed the letter of the officials of the Reichsbank as an engagement "to liquidate the Gold Discount Bank." The Reparation Commission accepted the Report of the Organizing Committee and the draft legislation annexed thereto, on August 9, 1924, and forthwith transmitted them, approved, to the German Government. By this action the Commission, as the agent of the Allies, adopted, as its own view of the meaning of the agreement with respect to liquidation, the interpretation given by the Report of the joint Organizing Committee. No objection to this interpretation of the Organizing Committee came from the German side during the period August 9 - August 30, 1924, and on the latter date, with the Report before it, the Reichstag voted the Bank and other pertinent Laws, including a law generally approving the acceptance of the terms of the Experts' Plan and the London Agreements.

The text of the Bank Law, far from being in any way inconsistent or incompatible with the Reichsbank letter of July 7, 1924, as interpreted by the Organizing Committee and adopted by the Reparation Commission, contained provisions which rendered



possible the easy execution of the understanding. The Reichsbank was authorized to take over the shares of the Gold Discount Bank and the Laws concerning the Gold Discount Bank were of necessity maintained in force (except in so far as they are inconsistent with the Bank Law), first, because there was no engagement on either side that the Gold Discount Bank should be liquidated at the very moment of the adoption of the Bank Law, and, second, because the fundamental Law relative to the Gold Discount Bank contained the following enabling language which had to be kept in force to permit the carrying into effect of the arrangement:

"Article 5. \*\*\*\*\* The Reichsbank has the right to liquidate the German Gold Discount Bank at any time, with the consent of the General Meeting of the German Gold Discount Bank."

While, therefore, it is literally exact, as stated on page 8 above, that the text of the Bank Law contains no specific mention of the liquidation of the Gold Discount Bank, as a matter of sound statutory interpretation Article 52 of the Bank Law has the effect of incorporation by reference of the foregoing Article of the Gold Discount Bank Law with the juridical result that the Reichsbank is now, and has been, entitled to liquidate the Gold Discount Bank "at any time". The consent of a general meeting of the interim bank has become a formalism considering that the Reichsbank is the sole owner of all the shares of the Gold Discount Bank.

On the basis of the foregoing record it is the considered opinion of the undersigned that an impartial arbitrator called upon to interpret the language employed by the parties would rule that



there was an agreement that the Gold Discount Bank should be liquidated; that no date was set therefor; that consequently the operation was to be concluded in a reasonable time; that what constituted a reasonable time depended upon questions of fact with regard to the operations of the Gold Discount Bank, and constituted a question to be decided amicably between the Reichsbank authorities and the appropriate administrators of the Dawes Plan; that the Reichsbank has to date, on the score of liquidation, not opened itself to the charge of violation of the original agreement in view of the tacit acquiescence, or even overt consent, of the responsible Allied authorities to the postponement of the time of liquidation. On this last point the Reichsbank would quite properly enter in evidence the following excerpt from its annual report for the year 1925, and a copy of the resolution of the General Council of May 23, 1925 :-

"In this connection it should further be mentioned that the German Golddiskontbank, which was deprived of its right of issue (which had, however, never been utilised) with the coming into force of the new Bank Law and had begun to liquidate its business, resumed its activities in April 1925 with the consent of all parties concerned, since it seemed desirable in the interests of German economy to retain this practical means whereby those interested in foreign trade can obtain foreign credits."

Resolution of May 23, 1925.

"The resumption of credits to be given by the Golddiskontbank has been approved."

It is equally the considered opinion of the undersigned that from the outset of the negotiations to their conclusion it was the intention on the Allied side wholly to liquidate the Gold Discount Bank at a reasonably early date. It is by no means so



clear that on the German side it was the intention to liquidate the Bank at an early date, or entirely. Indeed, Dr. Schacht, in his commentary on the Bank Law (Münz-u. Notenbankwesen, 1926), says "It was intended from the beginning, upon the creation of the Bank of Issue, to liquidate the Gold Discount Bank as an issue bank"(p.5) An impartial arbitrator would not, however, endeavor to ascertain the occult intention of the parties but would concern himself with the interpretation of the reasonable meaning of the language of the agreement which both parties finally adopted. Virtually every sincere legal dispute about the construction of an instrument arises out of the fact that one of the parties deems that he did not originally intend a certain consequence which nevertheless flows from the language of the accord which was ultimately jointly reached.

Finally, despite the space which has been devoted to the question of liquidation, it is the view of the undersigned that under present circumstances further debate on this subject as regards the past is likely to be sterile. The fact is that the Gold Discount Bank has not been liquidated and that the Allied representatives have acquiesced in the situation. The fact is that the Reichsbank has the continuing right to liquidate the institution "at any time". The real present problem is whether or not the Gold Discount Bank should be continued hereafter, or rather, the really important problem from the viewpoint of the Experts' Plan and the Bank Law is whether the Gold Discount Bank, if continued, may be employed by the Reichsbank for the accomplishment of purposes which



are either prohibited to the Reichsbank by the Bank Law of August 30, 1924, or at least unauthorized by that Law. To this latter question the legal answer is an unqualified negative.

The provisions relative to the functions of the new German Bank were at the very heart of the Experts' Plan for the stabilization, and the maintenance of the stabilization, of the German currency, and it is not surprising to find that the Annex which minutely details the essential powers of the proposed Bank is numbered Annex I, and to find that the discussion in the main text of the Report concerning the activity of the Bank is placed at the very beginning. The Experts, and later the Organizing Committee, entered into the most precise details concerning the prerogatives and scope of business of the Bank, with the clear intent of safeguarding the Bank from activities which had brought disaster in the past and with the intent of defining exhaustively the field of its activity for the future. The result of this careful study and this deliberate prescription of limitations was finally enshrined in the bank Law of August 30, 1924, the preamble of which reads as follows:-

"The following provisions shall henceforth apply to the legal condition of the Reichsbank which was incorporated by the Bank Law of March 14, 1875:"

This Law constitutes the charter of the Bank, and what is not there contained is ultra vires for the Bank; and what is there forbidden is definitively prohibited to the Bank, acting either by



itself or through one of its exclusive instrumentalities. The Bank Law is divided into nine sections containing fifty-three articles which completely, carefully and finally outline the entire legal status of the Bank and delimit the field of its legal operation. Section IV defines with special care "The Bank's sphere of Business" The Reichsbank is clearly restrained, if this Law and this Section have any valuable import, to the sphere of business there so carefully described and it is forbidden, either itself or by a subordinate agency, to carry on the prohibited business acts which are set forth in the Law. While it is true that Article 53 of the Law recognized the continued existence of the Gold Discount Bank ( at least until liquidation) which was to be wholly owned by the Reichsbank, is this enabling Article to be given a construction such as to open the door to the effective destruction of the 52 preceding articles concerning the legal condition of the Reichsbank? The mere putting of this rhetorical question implies the necessary answer.

The Gold Discount Bank is now in practical fact, despite its separate corporate entity, a department of the Reichsbank or, in any event, an exclusive instrumentality of the Reichsbank. Not only is the Reichsbank the sole owner, but the two Directorates are interlocking, the management is identical, and even the offices of the Gold Discount Bank are in the Reichsbank building. The real identity of the two institutions is accentuated by the device of the Solawechsel that provides a method by which the Reichsbank can put the Gold Discount Bank in funds out of the Reichsbank monies if and when the interlocking and identical executives so desire. The sphere of business of the Reichsbank having been deliberately and carefully



planned and defined, the Reichsbank is limited to that sphere and it cannot employ an instrumentality which, de facto, is substantially identical with itself, or, alternatively, is wholly and exclusively its subordinate agency, to accomplish purposes which are forbidden to the Reichsbank by the Bank Law, or unauthorized thereby. Any contrary conclusion renders all restrictions of the Bank Law purely illusory and would leave the Reichsbank more free to carry on business in accordance with its unbounded and changing discretion than it was prior to the Experts' Plan and the carefully conceived Law of August 30, 1924.

The necessity of this conclusion is confirmed by the existence of the General Council in which there is a foreign representation. That foreign representation was avowedly created with a view to affording guarantees to those who accepted the Experts' Plan and to those who floated the German External Loan 1924, that the Reichsbank would in fact be carried on in accordance with the spirit and design of the Experts' Plan and subject to the protective limitations which were laid down by the Organizing Committee and incorporated in the Bank Law. While the exact prerogatives of the General Council are not set forth in the Law, in the instant case this hiatus is not without advantages for if the Council have any useful powers at all they must at least have the implied power of general oversight of the activities of the Reichsbank with respect to its observance of the fundamental aims and spirit of the Experts' Plan and the essential provisions of the Bank's charter. The guarantee hoped for by the creation of the General Council falls utterly to



the ground if the Reichsbank is legitimately empowered through a subsidiary instrumentality to carry on business unauthorised or prohibited by the charter of the Reichsbank itself and if it can do indirectly what is expressly unwarranted.

In the opinion of the undersigned the responsibility rests upon the General Council and more particularly on the foreign members thereof to see to it that the Bank Law is not evaded through the agency of the Gold Discount Bank, and to assume with regard to the Gold Discount Bank the same surveillance which is exercised over the Reichsbank. If, as Dr. Schacht frankly states in his memorandum to the General Council, dated March 11, 1927, the existing Bank Law does not give the Reichsbank the necessary control of the internal credit situation, and if such control be desirable for the Central Bank, then the remedy is through an appropriate amendment to the Bank Law duly passed through the proper channels and not by the employment of a subterfuge in the shape of a subsidiary and wholly controlled corporation whose theoretical separateness is maintained. This is the more true when there is the strongest likelihood - if not almost the certainty - that the real obligation of the Reichsbank with respect to the Gold Discount Bank, instead of extending the scope of the latter and employing it as a means of circumventing the limitations of the Bank Law, is in reality to liquidate the institution at a reasonable date in agreement with the Allied administrators of the Experts' Plan.

LEON FRASER.

April 22, 1927.



Referred to in letter of 9/27/27  
S. Parker Letter to Gov. Strong



T.D. No. 222 B.

May 7, 1927.

MEMORANDUM ON THE ACTIVITIES OF THE GOLD DISCOUNT BANK.

At the meeting of the General Council on March 27, 1927, Dr. Schacht and Sir Charles Addis were appointed a sub-committee "to examine and report on the question whether it is in accordance with the intention of the Dawes Plan that the Gold Discount Bank is to be liquidated as soon as possible or, alternatively, whether it is to continue its present activities". Mr. Fraser's memorandum of April 22, 1927, has already covered this question from the legal standpoint. It remains to consider it from the banking and financial point of view.

It is necessary, first of all, to review the work undertaken by the Gold Discount Bank from its organization in 1924 up to the present time.

I. Review of the Activities of the Gold Discount Bank.

The Gold Discount Bank began operations on April 16, 1924, under a charter granted by law on March 19, 1924. Its authorized capital amounted to £10,000,000 sterling, half of which was subscribed by the Reichsbank and the other half by a consortium of German banks. The Reichsbank, for the purpose of paying its subscription, obtained a credit from the Bank of England in the amount of £5,000,000, which it repaid in April, 1925. By the end of 1924, the members of the consortium held fully-paid shares



amounting to £1,647,200. These the Reichsbank acquired in January, 1925, by exchanging its own shares for them, and thereupon became sole owner of the bank. From its organization, the management of the Gold Discount Bank has been in the hands of the Reichsbank, as the law in fact contemplated, and the President of the Reichsbank has been chairman of its Board of Control.

The law gave the Gold Discount Bank broad powers, but the main function which it performed from its establishment was that of granting credits in foreign currencies, mainly sterling and dollars, for the benefit of German foreign trade. In order to enlarge its credit-giving facilities, it made arrangements whereby it could rediscount bills abroad. Its business increased rapidly during the Spring and Summer of 1924, reaching a maximum immediately before the Experts' Plan went into force on September 1, 1924. The weekly statement for August 23, 1924, reported a total of £14,027,000 of bills, of which slightly more than half were under rediscount. With the coming into effect of the Experts' Plan and the reconstitution of the Reichsbank, its business became of less importance and gradually passed into the stage of liquidation. Its supplementary function, that of issuing a limited volume of currency notes in terms of sterling, was never exercised, and the new Bank Law withdrew the privilege altogether.

By the Spring of 1925 it was apparent that German foreign trade was still suffering from a lack of credit, and accordingly Dr. Schacht proposed a revival of the Gold Discount Bank's activities. The General Council at its meeting on March 23, 1925, discussed the matter, and its minutes record that:



"The resumption of credits to be given by the Gold Discount Bank has been approved".

In speaking of this action, the annual report of the Reichsbank for 1925 remarks that:

"The German Gold Discount Bank, which ..... had begun to liquidate its business, resumed its activities in April, 1925, with the consent of all parties concerned, since it seemed desirable in the interests of German economy to retain this practical means whereby those interested in foreign trade can obtain foreign credits".

The portfolio of the Gold Discount Bank thereupon began to increase again, reaching a maximum in October, 1925. At the end of 1925 it stood at only slightly less than £9,000,000, of which £1,600,000 was rediscounted abroad.

During 1926 the export credit business of the Gold Discount Bank again diminished in importance, coinciding with the rapidly developing ease on the German short-time money market. At the close of the year, the bills and checks in the portfolio amounted only to £380,400, though the annual statement reported bills under rediscount in the amount of £3,730,800. Practically all of these rediscounts were with the Reichsbank .

But while the work of the Gold Discount Bank in this particular was growing rapidly less, it was undertaking new functions in other directions. Early in January, 1926, the bank declared itself willing to take over 3-5 year agricultural mortgage bonds of the Rentenbank-Kredit-Anstalt at 7 per cent, which was well below the then prevailing rate. The announcement of this programme was of itself sufficient to accelerate the decline of interest rates on the mortgage market, and it proved to be one of the early and important factors leading to lower rates of inte-



rest on long-term obligations generally, and hence toward re-establishing the German market as the main source of credit for German long-term borrowers. The Rentenbank-Kredit-Anstalt was somewhat slow to take advantage of the Gold Discount Bank's offer, owing to technical difficulties in connection with registering the mortgages, but by the end of the year the bank held RM 220,750,000 of bonds, maturing in approximately equal instalments on July 15, 1929, July 15, 1930, and July 15, 1931. It may be remarked that this generous use of Gold Discount Bank credit toward the close of the year was not so much by way of placing fresh funds at the disposal of agriculture as it was by way of refunding a large part of the rentenmark agricultural credits, which fell due on November 30, 1926, in the amount of about 293 millions.

In December, 1926, the Gold Discount Bank entered upon a second new undertaking, which had to do with the sale to the market of one-name bills, known as Solawechsel. While, as has already been indicated, the cost of long-term money was gradually falling into equilibrium with long-term rates on foreign markets, short-term money had at times reached the point of redundancy. Cheap money on the Bourse had long been one of the causes of active speculation, but the Reichsbank's own portfolio was too small at the moment to permit it to sell bills to the market and so effect a correction. It endeavoured to produce the same result, however, through the medium of the Gold Discount Bank, which sold Solawechsel in the amount of RM 72,600,000. Of that amount the Verkehrs-Kredit-Bank bought RM 50,000,000, as an investment for railway funds. These bills, the proceeds of which were in-



vested in 3-5 year agricultural bonds, bore a rate varying from  $4\frac{1}{2}$  to  $4\frac{3}{4}$  per cent. They matured in March, when they were repaid with the exception of those purchased by the Verkehrs-Kredit-Bank, which at the request of the latter were renewed. A second issue of RM 20,500,000 was made in January, maturing in April. It is to be noted further that on March 7, 1927, about RM 13,500,000 of Solawechsel were under rediscount from the market at the Reichsbank.

A third new undertaking of the Gold Discount Bank has grown out of the arrangements, perfected early in 1927, for the conversion of the 10 per cent mortgage bonds of several so-called "Landschaften" into 7 per cent mortgage bonds. The Gold Discount Bank participated in a syndicate to finance the conversion, and while the seasonal ease of money then prevailing has in a measure given way to somewhat stiffer rates, 7 per cent mortgage bonds still have a good market, and the syndicate has not been called upon to furnish important amounts.

A fourth new undertaking of the Gold Discount Bank has been its acceptance of deposits at interest from the Government of the Reich. The Reich placed with the Gold Discount Bank early in 1927 RM 160,000,000 of the proceeds of the new Reich loan, for periods extending up to six months, at interest of  $3 - 3\frac{1}{2}$  per cent. Most of the money so deposited has been used for buying reichsmark acceptances in the market. Partly because of the large fund thus available, the rate on the private discount market has remained fairly steady since February, ranging between  $4\frac{1}{2}$  and  $4\frac{7}{8}$  per cent, in spite of a marked demand for funds



in other markets.\* The margin above the interest paid to the Reich has proved sufficient and on the whole advantageous to the Gold Discount Bank.

The changes in the activities of the Gold Discount Bank briefly indicated above are illustrated in the following table, which summarizes the annual statements published as of the ends of 1924, 1925 and 1926, and compares them with the monthly statement for March, 1927. It should be observed that the statement is given in terms of pounds sterling, the currency in which the Gold Discount Bank's accounts are kept.

(In thousands of £)

	1924	1925	1926	March 31, 1927
<u>ASSETS</u>				
Loans at call .....	535.1	255.4	75.0	25.7
Bills and checks ...	6,720.2	7,329.9	380.4	7,237.5
Other investments...	-	891.3	12,111.1	13,269.1
Miscellaneous .....	-	-	-	79.2
<u>LIABILITIES</u>				
Capital paid up.....	6,647.2	6,647.2	6,647.2	6,647.2
Legal reserve.....	20.4	20.4	44.6	70.1
Special reserve.....	-	-	-	1,000.0
Delcredere fund.....	55.0	55.0	115.0	290.0
Sola bills.....	-	-	3,553.6	3,452.4
Loans on collateral at the Reichsbank..	-	-	970.8	-
Demand deposits.....	70.5	66.6	23.7	7.4
Time deposits.....	-	1,117.2	691.5	9,132.2
Miscellaneous.....	74.3	85.9	9.8	12.1
Rediscount bills....	1,106.5	1,608.8	3,730.8	2,844.5

\* The bill rate rose to 5 per cent, on March 11, 1927.



## II Analysis of the Business of the Gold Discount Bank.

From the foregoing paragraphs it appears that the Gold Discount Bank has been operating from its very beginning in close affiliation with the Reichsbank, but that since the early part of 1925, when the Reichsbank became its sole owner, the Gold Discount Bank has been virtually a department of the Reichsbank, though still maintaining its corporate identity. While many of the functions performed by the Gold Discount Bank have been of undoubted importance to the German economy, particularly in those periods when their exercise was first undertaken, it is appropriate to examine them now from a double standpoint; first, as to whether if performed directly by the Reichsbank they would be consistent with the essential functions of a central bank, and second, as to whether these functions are of diminishing or increasing importance from the point of view of the general situation.

A. Granting credits in foreign currencies to German foreign trade.--- The sterling capital with which the Gold Discount Bank began operations gave it considerable facilities in this direction, and it was able to grant acceptance credits in sterling, for example, in precisely the same way as any other bank having substantial holdings of sterling funds makes a practice of doing. The ordinary functions of a central bank are at least one step removed from this direct relation with the merchant. The Reichsbank, it is true, is able to keep a certain proportion of its portfolio (33 per cent) in two name paper provided collateral security is provided, but its usual relation is with the market and not



directly with the merchant. Not infrequently, however, it has been called upon to rediscount bills for the Gold Discount Bank, a process which brought it through the medium of its subsidiary into direct relation with the merchant.

The high character of the bills so rediscounted relieved transactions of this sort from such risk as might otherwise attach to them, and the universal scarcity of credit in the early years of reconstruction gave such transactions a general utility which the General Council recognised when it approved in March, 1925, the resumption of this kind of business by the Gold Discount Bank. At present, however, the German banks have adequate facilities for granting credits to German foreign trade, and there is certainly no need for continuing the Gold Discount Bank on this account. The Gold Discount Bank, in fact, is not now so much a means which is sought after for the purpose of granting credits of this kind, as it is an investor seeking bills in the market in competition with other buyers. Its need to buy bills is the direct result of other functions recently assumed, particularly that of depositary for the Reich, to which explicit reference is made below.

B. Taking over from the Rentenbank-Kredit-Anstalt 3 - 5 year agricultural mortgage bonds.-- This undertaking may be regarded as a measure of emergency relief to the agricultural borrower. The announcement of the programme was of itself sufficient to stimulate the private market into buying mortgage bonds, not merely of the short maturities concerned in the plan



but of longer term. The Golddiskontbank in this operation was a convenient instrument which the Reichsbank used for the purpose of exerting pressure on the banks, and so forcing a cheaper market for agricultural mortgage bonds. Leadership of the market in times of emergency is to be expected from central banks, but it is open to question whether the central bank should be in a position to enforce its leadership through a subsidiary capable of acting in competition with the commercial banks.

The emergency which this action by the Gold Discount Bank was designed to correct has entirely passed. While the cost of long-term credit to agricultural borrowers is still much above what it was before the war, yet it is generally in line with the cost of long-term credit to industry and only slightly more than the cost of such credit to municipalities and States. Seven per cent mortgage bonds (Pfandbriefe) are now quoted in the market at 102 to 103, and five per cent Pfandbriefe at around 92. The fact that the mortgage bond market in March, even with money rates stiffening in other directions, was the most active in recent years, is further evidence that special assistance from the Gold Discount Bank is no longer required.\*

C. Sale of 3-months one-name bills (Solawechsel).-- This operation, upon which the President of the Reichsbank has written a special memorandum to the General Council, was essentially an effort on the part of the Reichsbank, acting through its

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\* Since the material for this memorandum was prepared, the market prices of Pfandbriefe have declined 1 to 2 points. On the whole the market remains active and steady. May 11, 1927.



subsidiary, to influence the money market in a manner roughly corresponding to that frequently employed by central banks. But whereas central banks ordinarily sell bills or Government obligations to the market out of their own portfolios, and so withdraw redundant funds from the market, the Reichsbank endeavoured to accomplish the same result by having the Gold Discount Bank sell its own promissory notes bearing solely its own name. The Reichsbank itself entered into the transaction by expressing its willingness to rediscount these bills if brought to it from the market. The volume of Solawechsel so rediscounted proved to be very small, but no doubt the action of the Reichsbank added materially to their attractiveness by assuring their complete liquidity. There is no object here in discussing the legal eligibility of these notes for rediscount, which involves an examination of their character as commercial bills. Instead the question is whether the whole transaction was consistent with central banking practice. Assuming that the Gold Discount Bank was entirely separate from the Reichsbank, not only as a corporate entity, but in its administration and ownership, and granted the eligibility of the bills, there can be no doubt but that the plan was not inconsistent with usual practice. But the identity of ownership and administration by which both maker and rediscounter were the same authority, tends to place the transaction outside the field of activity commonly accepted for a central bank. Its justification is not to be looked for in the law or in central banking practice, but only in the special condition which it was intended to combat.



The emergency nature of the transaction arose from the fact that the Reichsbank at that time had only a limited portfolio of bills, mostly of very short maturity, and that there were no Treasury bills of the Reich either in its possession or available for sale to the market. Consequently the Reichsbank did not have the means at hand to influence the market, and looked elsewhere for a substitute. In two respects the situation has now changed; there is no need for the Reichsbank to influence the market by a sale of bills, because market rates are now in contact with the Reichsbank rate; and the Reichsbank now has the largest portfolio it has had for many months. There are still no Treasury bills of the Reich, but for the moment neither the Reich nor the market has need of them. In ordinary course there probably will be Treasury bills of the Reich in the future, unless the Reich makes the mistake of issuing another long-term loan.

D. Participation in banking syndicate for the conversion of high-interest mortgage bonds into lower-rate mortgage bonds.--

In this operation the Reichsbank used the Gold Discount Bank more as an instrument of convenience than one of necessity. Except that the Gold Discount Bank was committed to providing funds during the process of conversion, in case funds should be called for, the leadership exerted by the Reichsbank was not unlike what it might have been had the Gold Discount Bank not existed.

The operation, while of undoubted value at the time, was of a transitory nature and may be passed over without further comment.



E. Depositary for public funds.-- This is without question the most important of the new functions assumed by the Gold Discount Bank. The Reich loan, which provided cash far in excess of the current demands upon the Treasury, revived the problem of administering the surplus funds of the Reich. At the same time, it is to be expected that the proceeds of the loan, like the surplus from taxation will in due course be exhausted in Government expenditure, so that this particular function of the Gold Discount Bank may be of a transitory character. But in the meantime other public or quasi-public funds are in prospect of flowing to the Gold Discount Bank as deposits at interest. This gives an aspect of permanency to the new function.

So far as the Reichsbank is concerned, the problem of the public funds has its origin in the desire to earn interest during such time as the funds are lying idle. If the heads of the various public institutions and the Reich Treasury itself were not desirous of getting a return on surplus, reserve, or idle funds, the main obstacle against placing them on deposit at the Reichsbank would be absent. The Reichsbank under the law is not allowed to pay interest on deposits. This prohibition grows out of the obligations of the central bank toward the currency and the situation of credit in general,-- or, as the Reichsbank law defines it, toward the regulation of "the circulation of money ..... and the utilisation of available capital". If the central bank, like a commercial bank, were obliged to earn interest on its deposits it would have to force money out into the market whether conditions were ripe for such



action or not. The possibility of competition with ordinary banks is only an incidental factor; the main objection is the implied limitation on the ability of the central bank to maintain control of the money market. In order to remain in contact with the market and thus keep its rate effective, the central bank must have unhampered power to affect the market either by withdrawing funds from it or by releasing funds to it. If it is consistently under the necessity of putting money out on the market in order to pay interest to depositors, its control is seriously limited; and it does not matter whether the money so put out is its own or that of a subsidiary.

It is true that, as compared with the Reichsbank, the Gold Discount Bank exercises a greater latitude in making investments, and has even, as in the case of the Rentenbank-Kredit-Anstalt's agricultural mortgage bonds, bought 3 to 5-year bonds for its own account. But there are distinct limitation on the extent to which a bank of deposit can invest in long-term obligations; and as to the various short-money markets, the partitions formerly dividing them into separate compartments are becoming thinner and lower, and it is doubtful whether any considerable volume of funds can now be forced into one short market without causing an outward flow in directions not desired. The Gold Discount Bank has already become an active applicant for domestic business in order to supplement the investments purchasable on the open market or from other institutions. On April 1, 1927, the Gold Discount Bank changed the practice prevailing



theretofore of granting credits solely in a foreign currency and began to grant reichsmark credits as well.

A settlement of the problem involved in the administration of the public funds is urgently needed, not only because of their influence in the money market, but for other reasons which it is unnecessary to discuss here. The new loan of the Reich revived it, probably temporarily; and it postponed the opportunity then open of providing in the shape of Treasury bills a highly liquid short-term investment for Railway and other funds. Pending the time when such obligations may be offered on the German markets, and without undertaking here to propose even in outline a plan for settling the problem, it is to be noted that the supply of bills is constantly increasing, that the Gold Discount Bank's own investments include obligations of both long and short maturity which are suitable for purchase for public account, and that the Reichsbank's portfolio is the largest in many months. Consistent administration of the public funds according to a plan which conforms with Reichsbank policy is clearly required, but if the Reichsbank is to fulfil its obligations toward the currency and the general condition of credit, it cannot guarantee a fixed return on those funds. Whether the guarantee comes from the Reichsbank directly or from its subsidiary the Gold Discount Bank is a purely technical matter and makes no difference in fact or principle.



III. The Intention of the Experts' Plan with respect to the Gold Discount Bank.

There is nothing in the Plan which indicates that its framers expected the Gold Discount Bank to remain in business or to extend its functions. Its implications, which find support in a direct statement in a letter from the Reichsbank Organization Committee to the Reparation Commission, looked instead toward its prompt liquidation. But it is recognized that under the extraordinary conditions of financial reconstruction which have prevailed in the last three years, it was not out of order that all reasonable means should be employed to make the transition as speedy and simple as possible. The Gold Discount Bank proved itself to be a highly useful instrument during a difficult period. Consequently, it is desired if possible to lift the discussion of the future of the Gold Discount Bank out of the plane of prior commitment, whatever it may have been, and to place it on the broader ground of central banking principle.

The Plan, both in the Report of the Experts and in the laws passed in accordance with it, placed about the Reichsbank the safeguards and gave it the responsibilities essential to the conduct of a central bank. These safeguards and responsibilities were expressed not only in general terms but in precise detail, and the detailed prescriptions are to be found not only in the Report of the Experts, but in the communications of the Reichsbank Organization Committee to the Reparation Commission and in the Bank Law itself. The Bank Law constitutes the charter of the Reichsbank, and what is not there contained is ultra vires for the Bank; and what is



there forbidden is definitely prohibited to the Bank, acting either by itself or through one of its exclusive instrumentalities.

The separate existence of the Gold Discount Bank as a corporation distinct from the Reichsbank is technical rather than actual. The Gold Discount Bank is the Reichsbank's exclusive instrumentality and in carrying out the intents and purposes of the Reichsbank it has the practical quality of a department of the Reichsbank. Not only is the Reichsbank its sole owner, but the two directorates are interlocking, the management is identical, and even the offices of the Gold Discount Bank are in the building of the Reichsbank. The convenience of the arrangement is undeniable, and under color of it the Reichsbank administration has performed functions which are forbidden to it acting in its own proper person. Each one of the five principal functions enumerated above, which the Gold Discount Bank has exercised since its inception, would in whole or in part be impossible of performance in the name of the Reichsbank itself. Indeed, the facility with which the Reichsbank can do things through the Gold Discount Bank which it would be restrained from doing directly, furnishes the main motive for the retention of the Gold Discount Bank as an operating instrument.

But the real identity of the two institutions opens the way not to action within the law but to evasion of the law. The Reichsbank is limited to the sphere of business deliberately and carefully defined and it cannot employ an instrumentality which de facto is substantially identical with itself, or, alternatively,



is wholly and exclusively its subordinate agency, to accomplish purposes which are forbidden to the Reichsbank by the Bank Law or unauthorized therein. Any contrary conclusion renders all restrictions of the Bank Law purely illusory and would leave the Reichsbank more free to carry on business in accordance with its unbounded and ~~changing~~ discretion than it was prior to the Experts' Plan and the carefully conceived Law of August 30, 1924. Furthermore, the fundamental obligations of the Reichsbank as a central bank are no less operative than the law itself to debar it from the continued exercise of extra-legal functions through the medium of a subsidiary.

If, as Dr. Schacht stated in his memorandum to the General Council, dated March 11, 1927, the existing Bank Law does not give the Reichsbank the necessary control of the internal credit situation, and if such control be desirable for the Central Bank, then the remedy is through an appropriate amendment to the Bank Law duly passed through the proper channels and not by the employment of a subterfuge in the shape of a subsidiary and wholly controlled corporation whose theoretical separateness is maintained.

(signed) SHEPARD MORGAN.



Referred to in letter of 9/27/27  
S. Parker Gilbert to Gov. Strong

Federal Reserve Bank  
797.24  
FILE ROOM  
no. 4

T.D. No. 222 D.

MEMORANDUM OF THE REICHSBANK-DIRECTORIUM ON  
THE ACTIVITIES OF THE GOLD DISCOUNT BANK.

BERLIN, May 24, 1927.

At the meeting of the General Council on March 28th 1927 the question has been raised whether the Deutsche Golddiskontbank ought to be liquidated. For the Reichsbank this is a question of a formal and a material aspect.

As far as the formal aspect is concerned the opinion that the Golddiskontbank ought to be liquidated is principally based on the report of the Organizing Committee of July 11th 1924 according to which the liquidation of the Golddiskontbank was provided for, but the time for such liquidation was not stipulated. The fact that the Golddiskontbank has so far not been liquidated is not contrary to the spirit of the Dawes Plan. The principal point as far as the Dawes Plan is concerned is that the note issuing privilege of the Golddiskontbank becomes invalid at the moment when the new Bank Law comes into force. The Managing Board of the Reichsbank felt itself obliged to examine the legal position in order to ascertain whether the existence and activity of the Golddiskontbank rest on a legally secured and incontestable basis. The conclusion come to is that § 53 of the Bank Law explicitly maintains the Golddiskontbank Law of March 19th 1924 with the exception of those provisions which regulate the note-issuing privilege of the Golddiskontbank.

As regards the material aspect the reason for the demand to liquidate the Golddiskontbank is that the Reichsbank may not



transact through a subsidiary establishment of which the Bank is the owner any business which the Bank itself is not allowed to do. Whether such an opinion can be substantiated by legal arguments shall for the moment not be discussed. The Managing Board of the Reichsbank does not wish to explain its policy in any way by purely formal aspects. Being the sole owner of the shares the Reichsbank fully realises that fundamental restrictions exist for the Board in regard to the management of the affairs of the Golddiskontbank. These restrictions are not the formal stipulations of § 21 of the Bank Law - the latter not having been declared applicable to the Golddiskontbank by § 53 of the Bank Law - but they result from the position and function of the Reichsbank as a note-issuing institution.

- a) The Golddiskontbank may only follow such aims and tasks which result from the position and functions of the Reichsbank as a note-issuing institution. The Golddiskontbank may only assist the Reichsbank in its public functions (§ 1 Bank Law);
- b) the transactions of the Golddiskontbank must not impose upon the Reichsbank any burden or entail any risks for the Reichsbank.

The Golddiskontbank has so far acted on these principles. Its activity was guided by the development of the German money market. Taking into consideration the transitory character of the Golddiskontbank, the Reichsbank applied itself to the liquidation of the affairs of the former. But then the Reichsbank was faced by a number of problems arising out of the further development of conditions in Germany, problems which only could



be solved with the assistance of the Golddiskontbank, as

- 1) the development of the German money market still followed very abnormal channels and as
- 2) it also appeared that several important tasks fixed by the Plan and vital to every Central Bank of Issue have only insufficiently or not at all been solved by legal measures.

These problems include above all the insufficient provisions of the Bank Law as regards placing the funds of the Reich, the Reichspost and Reich railway with the Reichsbank, as well as the provisions of the Railway Law of the Reich which explicitly prevent such placing of these funds with the Reichsbank. The unanimous opinion of the General Council and the Managing Board of the Reichsbank, as expressed verbally and in writing on many occasions, has always been that a Central Bank of Issue cannot fulfil its function in connection with the currency of its country unless it has control of the public funds. This point of view has with emphasis been put forward in public quite recently by the Governor of the Bank of England before the Indian Currency Commission.

As the Bank Law did not give sufficient power to enforce such a position, the Reichsbank made as far as possible use of the Golddiskontbank to exercise influence on the money market. The Reichsbank especially tried to adjust the market of short and long termed moneys by issuing 3-5 year agricultural mortgage bonds, and also attempted to restrict the short termed money market by issuing promissory notes. Finally the Bank tried to get hold of



the public funds by granting interest. All these means, which the Golddiskontbank in the opinion of the Managing Board of the Reichsbank was, and, no doubt, still is entitled to employ, may formally not be allowed to the Reichsbank itself. Materially they all lie within the policy of the Central Bank of Issue, and on no occasion has any use been made of the Golddiskontbank for any purpose which did not comply with the general policy of the Reichsbank. If the Reichsbank was compelled to make use of the Golddiskontbank the reason is in the first line the imperfect legal carrying out of the absolutely correct basic ideas of the Dawes Plan.

The Managing Board of the Reichsbank has done everything in its power to remedy these deficiencies by an adequate bank policy. It has always urged that the Reichsfinanzverwaltung should not work with surpluses, but should be supported by temporarily engaging the short-termed money market as much as possible. It has suggested the amendment of the Reichsbank Law, this facilitating the Reichsfinanzministerium the employment of the short-termed money market by issuing Treasury Bills. It has stipulated, not without success, tolerable relations with the Reichspost by means of proceedings. At last, with great difficulty, it has come to a provisional agreement with the Reichsbahn about the administration of a part of its short-termed funds, and it hopes that early next year, an agreement with regard to all Railway funds will be made for a long period. All this would have been impossible to do without the assistance of the Golddiskontbank. It must be said that the settlements concerning the administration



of the public funds hitherto made do not mean a satisfactory solution. It surely would be better, if the principle of the Dawes Plan would have been carried out, i.e. to leave the public funds of the Reich, Reichspost and Reichsbahn to the administration of the Reichsbank. However, the Managing Board of the Reichsbank would, as long as a more suitable settlement cannot be brought about, act contrary to its duty, if it would not do anything, to obtain as far as possible the control on the public funds - in spite of the deficient legal provisions.

The Reichsbank in the meantime aims at a solution of the problem as follows:

- 1) The funds of the Reichsfinanzverwaltung, Reichspost and Reichsbahn as well as of the smaller authorities of the Reich, as far as they are suitable for investment, are exclusively to be handed over to the Reichsbank which enters upon their administration. This line of business is kept quite apart from the other transactions of the Bank.
- 2) The funds are to be paid into the Reichsbank on non-interest bearing giro accounts. In each case the parties giving the moneys and the Reichsbank will agree upon their interest bearing employment. These agreements will establish the principles for the long-termed employment (e.g. investments in mortgage bonds, bills discounted in the open market, Treasury Bills of the Reich, special mortgage bonds etc.). If however no arrangement concerning some other investment responding to the aims and tasks of the Reichsbank can be agreed upon, the funds remain



with the Reichsbank on giro account not bearing interest. If an investment is agreed upon, the Reichsbank handles the funds entrusted as a trustee and on commission.

- 3) The proceeds are credited to the parties giving the moneys and paid in on their giro accounts. The Reichsbank does not charge any fee for administration.
- 4) This programme can, of course, only be carried out by degrees and gradually; in particular, the current agreements between the Golddiskontbank and Verkehrskreditbank, running till the end of the year, must not be broken off. On the contrary they are deemed to be the first step towards the direction indicated.

Germany still lives under anomalous economic conditions. As the Experts' Report points out as well, normal conditions on the money and capital markets are of vital importance to the economic reconstruction of Germany.

The pith of the whole question lies therefore in the practical demands of the policy of the Central Bank of Issue. First of all, this means the necessity to control the currency and the money market. As long as it is evident that vital needs of Germany's trade and industry cannot be satisfied in any other way, in particular as far as the Reichsbank is responsible, allowance has to be made to these imperative demands which have under any circumstances to be taken into consideration, whatever one's opinion might be looked upon it from the formal point of view. The Reichsbank has to go its way, given by its tasks, the more decidedly still, because these tasks represent just the



fundamental demands, the main principles and aims of the Dawes Plan; these are: reconstruction of German trade and industry, German credit, reestablishment of normal and settled conditions on the money and capital markets.

To liquidate the Golddiskontbank immediately does not serve this purpose of reconstruction but just means destruction. It is the duty of the Managing Board to draw the attention to the heavy responsibility for such a resolution.



ANNEX TO THE MEMORANDUM OF THE REICHSBANK-DIRECTORIUM,  
DATED MAY 24, 1927

Collection of facts regarding the  
Deutsche Golddiskontbank.

- a) translation of the laws
- b) letters and records.



U E B E R S E T Z U N G.

Law concerning the German Gold Discount Bank, March 19,  
1924 (Reichsgesetzblatt II p.71).

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The Reichstag has adopted the following law, which is hereby promulgated with the assent of the Reichsrat.

§ 1.

A bank is being established under the direction of the Reichsbank, out of private means and independent of the Government of the Reich, bearing the name "German Gold Discount Bank", licenced to issue pound sterling notes to a total value of 5 million pounds sterling. The notes are not legal tender.

The G.G.D.Bk. has its seat in Berlin. It has the character of a corporate body of the civil law, the legal decrees concerning companies of limited liabilities being applied so far as nothing to the contrary is fixed by this law or the rules of the Bank. The rules are drawn up by the founders; they will be made public.

As long as the privilege of the G.G.D.Bk. lasts to issue notes, no such privilege can be conferred upon banks, which at the time of coming into force of this law are not already banks of issue. This stipulation ceases at the liquidation of the G.G.D.Bk.

§ 2.

The Bank is bound to have in hand as cover for its notes in circulation at any time at least 50 per cent in gold or short-sighted bills of exchange, the rest in discounted bills or checks made out in foreign currency effective.

Gold, in the sense of this stipulation, is understood to be bar-gold, calculated at the rate of the last known London gold price, as well as inland and foreign gold coins.

Bills of exchange in the sense of this stipulation are banknotes and such bills, checks and claims, daily falling due, payable abroad in foreign currency.

The conversion of all coins and exchanges, other than pounds sterling, takes place at the last known London average closing quotation.

The maturity of bills must not surpass 3 months, bearing as a rule the signatures of three, but at least of two persons known as solvent. The checks must bear the signatures of at least two persons known as solvent.

§ 3.

The G.G.D.Bk. is bound to redeem its notes on presentation at its counters in Berlin to their full nominal value. The redemption takes place at the option of the Bank through checks on London, or transfer on London, or through notes of the Bank of England. The presentation for redemption does not signify an order in the sense of § 2 of the law concerning the flight of capital as formulated in the publication of January 26th 1923 (Reichs-Gesetzblatt I page 91).

§ 4.

The G.G.D.Bk. has to publish its rates of discount.

§ 5.

The privilege of the Bank to issue notes expires with the right of the Reichsbank to issue notes, but not later than the 31st December 1934. It may be prolonged by law.

The Reichsbank is entitled to wind up the G.G.D.Bk. at any time. The liquidation needs the consent of the general meeting of the G.G.D.Bk.



§ 6.

The direct and indirect granting of credits of any kind to the financial administrations of the Reich, the states, and communities, or the assumption of guarantee for any of the above named is interdicted to the Bank.

§ 7.

The shareholders have a claim to a yearly dividend of 8 per cent. Should one year the dividend not be attained, the amount short thereof is to be made up, as prior lien, out of the net profits of the following years.

Out of the remaining net profits 50 per cent have to be diverted to the Reich as recompense for the grant of the privilege of issuing notes. An obligation to taxation of the notes does not exist.

§ 8.

The stipulations of the commercial code, regarding the entry in the trade register and the legal consequences arising out of same, do not apply to the G.G.D.Bk.

Also the stipulations of the commercial code contained in the §§ 40 alinea 1, 180, 182, 186 to 209, 218 to 220, 227, 240, 243, 244, 252 alinea 3, 259, 265 alinea 2, 266 to 270, 277 to 279, 280, 281, 284 to 287, 289, 291, 292 alinea 1 number 2, 293, 295 alinea 2, 3, 296, 302, 303, 309 to 311, 313, 314 alinea 1 no. 3, 4, 5, 315 alinea 1 no. 2, 319, as well as the decrees concerning the gold balances of December 28th 1923 (Reichs-Gesetzbl. I page 1253) do not apply to the G.G.D.Bk.

§ 9.

The stipulations of the stock exchange law concerning the

issue of a compulsory prospectus do not apply to the G.G.D.Bk.

§ 10.

The management and liquidation of the G.G.D.Bk. lies exclusively in the hands of the Reichsbank.

All persons concerned with the management and direction as well as with the control of the Bank are pledged to secrecy in connection with all transactions. Opposing regulations to other laws do not apply to the G.G.D.Bk. The stipulations of the penal code and the decree of the public tax bill of the Reich (Reichsabgabeordnung) remain untouched.

§ 11.

The G.G.D.Bk. is exempt of all taxes of the Reich, the states and the communities with the exception of the bill duty and as long as nothing to the contrary results out of alinea 2 of the tax on bourse-transaction. Its business transactions and deeds are exempt of stamps and duties.

In handing over means of payment in foreign currency to the G.G.D.Bk. the sellers enjoy the same abatement of tax prevailing by sales to the Reichsbank. The redemption of the notes (§ 3) is exempt of the tax on bourse-transactions.

The dividends to be paid by the G.G.D.Bk. are not liable to the tax on capital yield.

§ 12.

The stipulations of the legislation on foreign exchanges are not applied to the G.G.D.Bk. The same applies to the stipulation of § 7 no. 2 of the bank law.

The Bank is entitled to carry on "Depot and deposit business" (§ 11 and 12 of the Law concerning the



Flight of Capital in the wording of the publication of January 26th 1923, Reichs-Gesetzbl. I page 91).

§ 13.

The notes of the G.G.D.Bk. do not count as foreign means of payment in the sense of the legislation on foreign exchanges; they are exempt of the tax on bourse-transactions § 2 of the decree concerning the speculation in foreign exchanges of May 8th 1923 (Reichs-Gesetzbl. I page 275) and the stipulations in force regarding the unity quotation are applied to the notes of the Bank, as far as the Government of the Reich does not stipulate anything to the contrary.

§ 14.

The law becomes operative the day following its promulgation

Berlin, March 19, 1924.

U E B E R S E T Z U N G.

Law for the Amendment of the Bank Law,

March 19, 1924

(Reichsgesetzblatt II p. 73).

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The Reichstag has adopted the following Law which with the assent of the Reichsrat is hereby promulgated.

§ 1.

The Reichsbank and the Private Note Banks are empowered to acquire and to grant loans on shares of the Deutsche Golddiskontbank.

§ 2.

The Reichsbank is entitled and is under the obligation to manage the whole business of the Golddiskontbank for the account of the Golddiskontbank. The President and the members of the Managing Board of the Reichsbank have the right to join the Board and the other managing or controlling bodies of the Deutsche Golddiskontbank; § 16 of the Reichsbeamten-gesetz does not apply.

§ 3.

Should the Reichsbank take over the Deutsche Golddiskontbank, the Reichsbank is entitled to increase its capital correspondingly.

§ 4.

This Law comes into force the day after its promulgation.  
Berlin, March 19, 1924.



U E B E R S E T Z U N G

§ 53 of the Bank-Law  
of August 30, 1924.

Subject to the provisions contained in § 52 above the Bank Law of the 14th March 1875 and the Laws amending the same shall cease to be in force except the Law of the 19th March 1924 (Reichsgesetzblatt II, page 73). At the same time the provisions of the Rentenbank Ordinance of the 15th October 1923 (Reichsgesetzblatt I, page 963) and of the Law relating to the German Gold Discount Bank of the 24th March 1924 (Reichsgesetzblatt II, page 71) shall cease to be in force in so far as they are in contradiction with this Law.

Der Präsident

des

Reichsbank-Direktoriums

BERLIN, S.W. 19, den 6.2.24.

Owen D. YOUNG, Esq.

Chairman of the Currency Sub-Committee

Hotel Adlon

Berlin

Mr. Chairman:

As I have been informed to my regret that the Sub-Committee dealing with the currency will finish their work in Berlin shortly I beg to submit to you the following.

Immediately after having been appointed President of the Reichsbank I have endeavoured for the recovery of German trade to create a Goldbank, which, independent of the ultimate settlement of reparations, of the budget and of our currency should be in a position to act effectively and on a safe basis. During those endeavours your Expert Committee asked me to come to Paris and to deposit my statements before the Committee. I have given to the Committee in Paris as well as afterwards in Berlin all explanations wanted with that frankness, which I consider to be indispensable regarding the most serious problems with which the Committee as well as myself were confronted. The Committee informed me that they were agreeing with me about some essential points, but that the Committee had in mind a more ultimate plan about which we all agreed that it could only become effective together with a definite settlement of the reparations and a balancing of the German budget.



I have no doubt that an arrangement between the Reparation Commission and the German Government about the ultimate plan of a currency bank can be agreed upon in connection with an agreement about the whole of the problems dealt with by the Experts Committee. As a non-politician however and as a man who is in business and economic life for more than twenty-five years I beg to call your attention to the most important point, that the present state of German currency and German trade does not allow to defer the measures initiated by me after my appointment. The actual provisory stabilising of German currency through the Rentenmark has only become possible by exercising a strong psychological pressure on all speculating circles and as a consequence thereof by an extraordinary shrinking of German production. For the time Germany is to a very large extent living on her stocks which give employment to her industry only to a certain percentage. The number of unemployed is enormous. This state cannot last any longer. People must try again to get foreign raw stuffs and materials in order to employ commerce and trade, but the necessary foreign exchange for that purpose are not at hand. Already since some time a greater demand for foreign exchange is to be seen, against which no sufficient receipts of foreign money are collected. The lack cannot be filled up by the private foreign credits, which during the last two months in consequence of the provisory stabilisation of the mark have been granted to our industry and commerce. Those credits will be withdrawn at the same moment, when doubts will arise whether such provisory stabilisation will last or not.

In view of that state and being formally responsible to the German Government for that all necessary measures in monetary policy shall be taken in time, I beg to approach you, Mr. Chairman, to ask your Committee for a declaration that the Committee approves my endeavours in an immediate creation of a gold bank, the outlines of which I have handed over to you, delivering the necessary funds for our commerce and trade until the time for an ultimate solution, as planned by your Committee will have reached. I consider myself in accordance with the Committee that the creation of such a gold bank shall not in any way prejudice the ultimate currency plan of the Expert Committee.

I am under the obligation to approach your Committee with such a demand because the Committee has given official notice that they in approving the fundamental features of my plan are outlining a somewhat different ultimate currency project. As for the creation of the gold bank planned by myself I am dependent on the moral help of foreign countries, especially of the various European central banks, a declaration of the Committee in the sense that they approve my provisory endeavours is indispensable.

Believe me

Mr. Chairman

Yours very truly

Reichsbankpräsident



38. 'The work of the First Expert Committee has enabled it unanimously to lay down the broad lines which it will recommend for the establishment of a new German Bank of Issue on a gold basis, which will exchange its own notes against those of the Rentenbank and the Reichsbank.

' The general principles of this plan have been communicated to Dr. Schacht, who is very clearly of the impression, shared by the Experts themselves, that if it is put into execution it will prove to be the most important step towards the definite stabilisation of the German exchange and the balancing of the Budget.

' The Expert Committee will inform the Reparation Commission that, in its opinion, the plan which the Committee will submit to it should be put into prompt operation.

' Dr. Schacht has informed the Committee that, in making his plans for the formation of his Gold Bank, he is so arranging matters as to facilitate its absorption by the Bank of Issue which will be proposed by the Committee.

' The Expert Committee will meet Dr. Schacht on the 18th instant at Paris.

39. Dr. Schacht agreed to the text of the draft communiqué and warmly thanked the Committee.

40. M. Francqui explained that the Committee wished to distinguish what it was doing from what Dr. Schacht wished to do.

41. Dr. Schacht said he fully understood the Committee's position: it was not a free agent and could not make any suggestion without authority from the Reparation Commission.

42. The Meeting adjourned at 6.15 p.m.

BANK SUB-COMMITTEE.

NOTE HANDED IN BY DR. SCHACHT  
ON HIS GOLD DISCOUNT BANK SCHEME  
ON FEBRUARY 19, 1924.

The bank to be founded not to be a currency bank but a credit and discount bank. The share-capital to be at least 200 and at a maximum 400 million marks. Up to 100 millions of the capital to be subscribed by the Reichsbank. The shares to be subscribed by the Reichsbank called "A" to have a controlling vote, thus enabling the Reichsbank at any moment to liquidate or to take over the discount bank. The subscription on the shares of the discount bank to take place in Germany and in foreign countries chiefly with the central banks and in Germany with the banks to become included into the syndicate to be formed by the Reichsbank. Subscribers will be obliged to exchange their shares for new shares. However, the Reichsbank or the new bank envisaged by the Experts will have the right, instead of exchanging the entire amount of subscribed shares, to reimburse part of them in cash, but only up to 50 %.

At the time of liquidation the accounts of the Bank will be duly checked by an auditor nominated by the Governor of the Bank of England.

Profits or losses will belong to, or be borne by, the shareholders of the Bank.

Finally, it would be understood that, in any case, German shareholders of the Discount Bank will be obliged to subscribe at least half of the capital which will be decided on for the new



bank envisaged by the Experts.

The above undertakings will be taken by the Reichsbank, which will supervise the Discount Bank. To this end, it will send a letter containing such undertaking to Nr.....

The shares called "B", bearing a minor vote, to receive in compensation a higher dividend than the "A" shares. The subscribers to receive an amnesty for having disregarded the various ordinances as to "Flight of Capital", taxation, etc., up to the amount subscribed. The coupons of the shares to be free of taxation, but not the income in the hands of German holders. The shares to be on bearer. Every political influence on the discount bank to be excluded. The German Government to be bound not to grant new rights of issuing notes for the time of the discount bank's existence. The seat of the discount bank to be in Berlin, its management to be in the hands of the Reichsbank. The discount bank to co-operate in foreign countries with the central banks.

In case and as far as the discount bank shall issue notes, these to be covered by gold or foreign valuta up to at least 50 %. This cover to be reduced to  $33 \frac{1}{3}$  % by a  $\frac{3}{4}$  majority's vote of the managers and the directors. The Reich to receive a share in the profits of the bank of 50 % of the remaining profit after a cumulative dividend of 8 % having been paid to the shareholders. The remaining 50 % to be reserved to the shareholders. As to the question on what foreign valuta the accounts and the notes of the bank shall be based, this will have to be decided according to practical requirements.

23.2.24.

C. Owen Young, Esq.

Ritz Hotel

Place Vendôme

P a r i s.

Dear Mr. Young:

As you know I have hurried to come here because I am only too anxious to start the Discount Bank for reason of the present German currency position. The situation here is still very much on the point and I have to act very quickly but at the same time very carefully. Now there arises one difficulty, which I want to explain to you and on which I want your advice, if you will kindly give it to me.

We decided in Paris that the Discount Bank should be controlled by the Reichsbank, as to enable the Reichsbank either to liquidate the bank or to take it over. In discussing the plan with the German bankers and in outlining the prospectus of the Discount Bank it had to be decided in what case and on what conditions the Reichsbank will take over or liquidate the Bank. As to the liquidation, this is easy to answer but as to the taking over, it is not. Our intention in Paris was that in case of taking over the Discount Bank the shareholders of the Discount Bank should exchange their shares against the respective amount of shares of the new Gold Currency Bank, the definite shape of which will only become apparent after the definite Reparations agreement between the Allies and the German Government will have been made. So it is left to the discretion of the Reichsbank to decide



whether the Reichsbank shall liquidate the Discount Bank or take it over for the Currency Bank. If this would be stated in the prospectus nobody would subscribe, on the other hand it cannot be concealed from the readers of the prospectus; so the only way out seems to be to liquidate the Discount Bank. However I do not want the Reichsbank to undertake towards you two alternative engagements, of which it is stated beforehand that only one can be carried out. I should therefore like to ask you and your Committee to agree with me about the following statements of the prospectus and of the Reichsbank respectively.

1. Statement of the prospectus:

The Reichsbank to control by the shares A the majority of the General Meeting of the Discount Bank. The Reichsbank to hold these controlling shares for the time of existence of the Discount Bank, such majority to be entitled to liquidate the Discount Bank any time.

2. Statement of the Reichsbank:

In case of an international agreement with the German Government through which the formation of one German General Gold Currency Bank according to the suggestion of the Experts Committee is to take place, the Reichsbank will use all its influence to include the Discount Bank into such scheme within the lines of our Paris conversations.

I shall feel very much obliged if I could have an affirmative telegraphic answer from you on the subject.

Believe me,

dear Mr. Young,

Yours very truly,

Copy.

Sub-Committee on Currency

Minutes of a meeting held in Paris on March 3, 1924.

Sir Robert KINDERSLEY being in the Chair.

Were present:

Sir Robert Kindersley, G.B.E., (United Kingdom)

M. Parmentier (France)

Professor Flora (Italy)

M. Emile Francqui (Belgium)

In attendance:

M. Mathieu, of the General Secretariat.

Specially summoned:

Dr. Schacht and Dr. Meyer.

- 
1. The Sub-Committee and Dr. Schacht agreed on the following modified text of the note handed in by Dr. Schacht on February 19th 1924, on his Gold Discount Bank scheme.
  2. "The Bank to be founded not to be a mere currency Bank but a credit and discount bank. For share capital, a maximum of 200 millions is contemplated, of which 100 millions are to be subscribed by the Reichsbank. The shares to be subscribed by the Reichsbank called "A" to have a controlling vote, thus enabling the Reichsbank at any moment to liquidate or to take over the discount bank\*. The subscription on the shares of the discount bank to take place in Germany and in foreign countries, chiefly with the

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\* The words underlined to take out, I think. Scht.



central banks and in Germany with the banks to become included into the syndicate to be formed by the Reichsbank.

3. "The Reichsbank will thus have through the "A" shares a majority on the general meeting of shareholders of the discount bank. The Reichsbank will hold these shares which give it the majority, during the whole period of the existence of the discount bank; this majority will have the right to liquidate the discount bank at any moment.

4. "At the time of liquidation the accounts of the bank will be duly checked by an auditor nominated by the Governor of the Bank of England.

5. "Profits or losses will belong to, or be borne by, the shareholders of the Bank.

6. "In case of the creation of a Bank of Issue in accordance with the suggestions which the Experts contemplate making to the Reparation Commission, the shareholders of the Discount Bank will have the right at the time of the liquidation of the Discount Bank, to subscribe at par, to shares of the new Bank of Issue if, and when formed, for a nominal amount equal to the nominal value of their shares in the Discount Bank.

"The shares called "B" bearing a minor vote, to receive in compensation a higher dividend than the "A" shares. The subscribers to receive an amnesty for having disregarded the various ordinances as to "Flight of Capital", taxation, etc., up to the amount subscribed. The coupons of the shares to be free of taxation, but not the income on the hands of German shareholders. The shares to be on bearer. Every political influence on the discount bank to be excluded. The German

Government to be bound not to grant new rights of issuing notes for the time of the discount bank's existence. The seat of the discount bank to be in Berlin, its management to be in the hands of the Reichsbank. The discount bank to co-operate in foreign countries with the central banks.

8. "In case and as far as the discount bank shall issue notes, it can only do so for a maximum total of 100 million marks gold, and in exchange for foreign currencies, it must always be covered by gold or foreign valuta up to at least 50 %. The Reich to receive a share in the profits of the bank of 50 % of the remaining profit after a cumulative dividend of 8 % having been paid to the shareholders. The remaining 50% to be reserved to the shareholders. As to the question on what foreign valuta the accounts and the notes of the bank shall be based, this will have to be decided according to practical requirements."

9. These arrangements are arrived at with Dr. Schacht on the understanding that he is prepared to do his utmost to facilitate the amalgamation of the Discount Bank and the Bank of Issue when formed, in accordance with the minutes of the meeting of the 9th February 1924.

signed: R.M. Kindersley

Dr. Hjalmar Schacht.



Report of the Organisation Committee for the  
Bank to the Reparation Commission.

.....

A letter is attached hereto signed by the President of  
the Bank and a member of the Reichsbank Direktorium  
undertaking to do what is necessary to exchange the shares  
of the Gold Discount Bank for shares of the Reichsbank  
and to proceed with the liquidation of the Gold Discount  
Bank.

.....

Berlin July 11th 1924

signed: R.M.Kindersley

Hjalmar Schacht.

U E B E R S E T Z U N G

Letter of the Reichsbank-Direktorium to  
the Organisation-Committee, July 7, 1924  
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Reichsbank-Direktorium

34-36 Jägerstr.,  
Berlin S.W.19.

7th July 1924.

To the Organisation Committee for the Bank:

Sir Robert Kindersley

Dr. Hjalmar Schacht.

We hereby beg to state that after the reorganisation of the Reichsbank in accordance with the Dawes Plan we shall take all necessary steps to acquire all the shares of the German Gold Discount Bank by exchanging them against new Reichsbank shares and to liquidate all transactions of the Gold Discount Bank.

As to the Dollarschätze we shall consider whether it will be in the interests of the Reichsbank either to acquire the outstanding balance by purchase in the open market or by redemption in dollars at maturity or to offer to the owners of the Dollarschätze new Reichsbank shares in exchange of an equivalent amount of Dollarschätze.

Reichsbank-Direktorium

signed: Hjalmar Schacht.

Vocke.



President of the  
Board of Directors of the

Reichsbank  
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BERLIN, December 23rd 1924.

Confidential (To the Members of the  
General Board)

.....

The investments of the German Gold Discount Bank, i.e. the holdings of bills and checks, to add the bills rediscounted, slowly declined from week to week from 10.5 million £ on November 23rd to 8.8 million £ on December 15th. The liquidation of these credits has to be done with the necessary care with regard to commerce and industry, concerned thereof. As regards the conversion of the shares of the Gold Discount Bank into Reichsbank shares, provided by the consortium contract (between the Board of Directors of the Reichsbank and the Consortium for the placement of the German Gold Discount Bank shares) and by Bank Law, there is now a decision of the Board of the Reichsbank at hand, published on 21st of December in the press, purporting that the conversion has to take effect on January 1st 1925 and that the amount of new Reichsbank shares required for this purpose, has to be emitted in the limits of the increase of capital, decided upon

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Referred to in letter of 9/27/27  
L. Parker Gilbert to Gov. Strong

May 15, 1927

797.2A  
no. 5

T.D. No. 222 E.

RESOLUTION AS AGREED UPON BETWEEN SIR CHARLES  
ADDIS AND DR. SCHACHT AND ADOPTED BY THE GENERAL  
COUNCIL OF THE REICHSBANK ON MAY 30, 1927.

Whereas, the General Council has considered the reports of Dr. Schacht and Sir Charles Addis, called for at their meeting on March 28, 1927, and

Whereas, it is agreed that the control of currency and credit, which is essential to any sound system of Central Banking, cannot be effectively exercised by the Reichsbank so long as public and quasi-public funds, the amount of which is not determined by the bank rate of discount, remain outside the management of the Reichsbank, and

Whereas, in terms of the Reichsbank Direktorium's letter of July 3, 1924, the Gold Discount Bank has to be liquidated within a reasonable time, it is

Resolved:

That pending the liquidation of the Gold Discount Bank, which the Council recognise has proved a valuable adjunct to the Reichsbank in dealing with an emergency and ad interim situation, every effort shall be made to ensure that in future the employment of all public and quasi-public funds shall be entrusted to the Reichsbank alone, and that in the meantime no new business shall be entered into by the Gold Discount Bank without previous consultation by the President with the General Council.



REPORT TO THE GENERAL COUNCIL OF THE REICHSBANK  
ON THE POSITION OF THE GOLD DISCOUNT BANK  
IN RELATION TO THE DAWES PLAN.

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At a meeting of the General Council of the Reichsbank on March 27, 1927, Dr. Schacht and Sir Charles Addis were appointed a Sub-Committee

"to examine and report on the question whether it is in accordance with the intention of the Dawes Plan that the Gold Discount Bank is to be liquidated as soon as possible or, alternatively, whether it is to continue its present activities".

Origin of Gold Discount Bank.

2. The reasons for the creation of the Gold Discount Bank will be found shortly stated in Dr. Schacht's declaration before the Budget Commission of the Reichstag on March 8, 1924: "My sole object," he said, "was always to extract gold capital from abroad .... I considered that this appeal for foreign capital would be more likely to succeed if it were suggested to create a bank ...."

3. The Statutes of the Gold Discount Bank were agreed on April 7, 1924.

4. Two days later, on April 9, 1924, the First Committee of Experts, in their report to the Reparations Commission, refer to the Gold Discount Bank as the "interim bank", and add that they have "assured themselves .... that the Bank would be so organised as to facilitate its absorption into a new bank of

issue which might be set up in accordance with the recommendations of the Committee".

5. On July 11, 1924, the Reichsbank Direktorium addressed a letter to the Organising Committee, consisting of Sir Robert Kindersley and Dr. Schacht, stating that "after the reorganisation of the Reichsbank in accordance with the Dawes Plan we shall take all necessary steps to acquire all the shares of the German Gold Discount Bank .... and to liquidate all transactions of the Gold Discount Bank".

6. It would be absurd to argue that this latter meant that as soon as "all transactions" of the Gold Discount Bank were liquidated, it should be free to enter into a series of new transactions! It could only mean that the affairs of the Gold Discount Bank were to be finally wound up. This is confirmed by the Experts' description of the Gold Discount Bank as an "interim bank" and their statement that it would be "absorbed" in the new Bank. That the Reichsbank undertook to liquidate the Gold Discount Bank, and not merely its current transactions, is plain from the language of the Organising Committee's Report which was signed by Dr. Schacht. The Reichsbank is "to do what is necessary to exchange the shares of the Gold Discount Bank for shares of the Reichsbank and to proceed with the liquidation of the Gold Discount Bank". It was this statement which was submitted when the Reparations Commission, acting for the Allies, was asked to approve the Bank Law and attendant documents as carrying out adequately the recommendations of the Experts Committee.



7. No objection was raised in Germany to this statement of the Organising Committee and accordingly on August 30, 1924, the Reichstag, with the Report before it, voted the Bank Law and approved the acceptance of the Experts' Plan and the London Agreements.

Bank Law of 1924.

8. There is nothing in the Bank Law in any way inconsistent or incompatible with the interpretation placed by the Organisation Committee on the Reichsbank letter of July 7, 1924; on the contrary, it contains provisions to facilitate the execution of the Reichsbank's undertaking to liquidate the Gold Discount Bank "at any time".

9. The intention of the Dawes Plan is clear: the Gold Discount Bank is to be liquidated. The date is not fixed, but on no rational basis of interpretation can "at any time" be held to mean other than a reasonable time after the acquisition of the Gold Discount Bank's shares by the Reichsbank.

10. The Bank Law is to be read in the light of the Report of the Organisation Committee, which was submitted to the Reparation Commission before it approved the Bank Law and to the Reichstag before it voted it. The General Council was created for the avowed purpose of providing a guarantee that the Reichsbank would be carried on in accordance with the spirit and design of the Experts' Plan and subject to the limitations laid down by the Organising Committee and

incorporated in the Bank Law. It cannot be seriously contended that Article 53 of the Bank Law, in which the existence of the Gold Discount Bank at least until liquidation is recognised, is open to the construction that it enables the Gold Discount Bank to override the limitations imposed on the Reichsbank in the two and fifty preceding articles. Such a construction would render all the restrictions of the Bank Law illusory and leave the Reichsbank greater freedom in carrying on its operations than in fact it possessed before the Experts' Plan and the limiting Bank Law of August 30, 1924, came into force.

Liquidation of Gold Discount Bank.

11. It is not suggested that the continued existence of the Gold Discount Bank as such involves a violation of the Law, but there is the danger of a contravention of the spirit of the Law if the functions of an instrument or department of the Reichsbank, a provisional institution which has already fulfilled its purpose, are extended beyond the period when they might properly be assumed by the Reichsbank itself. It is patent both to law and to common sense that the Gold Discount Bank, which is now an integral part of the Reichsbank, may not be used for any purpose which is prohibited to the Reichsbank by the Bank Law of August 30, 1924, or which is not expressly authorised by that Law.



If, therefore, the continued existence of the Gold Discount Bank should lead to its being employed in transactions which were not open to the Reichsbank, then a breach or evasion of the Bank Law would be constituted and no member of the General Council would be absolved from personal responsibility if he failed to enter a protest against it. The proper remedy for any defect in the Law, which may be held to cripple and impede the Central Bank in the due exercise of its control of currency and credit, is to amend the defect by appropriate legislation and not to try to circumvent it.

12. The obligation of the Reichsbank to liquidate the Gold Discount Bank has never been in question. The only point at issue is when the liquidation is finally to take place.

#### Dollar and Sterling Credits.

13. Within the first year of its existence the liquidation of the Gold Discount Bank was already far advanced. With the growing effectiveness of the Experts' Plan and of the reconstituted Reichsbank the main function of the Gold Discount

Bank, which was to grant credits in sterling and dollars, was gradually falling into desuetude. The time seemed ripe for allowing the Gold Discount Bank, having served its purpose, to terminate its existence by a natural death. Unfortunately, Germany's foreign trade at the beginning of 1925 was again in danger of being starved by a lack of credit, and, in order to supply the deficiency, the General Council agreed on March 23, 1925, to a temporary resumption of credits by the Gold Discount Bank. By the end of 1926, the Gold Discount Bank's holdings of bills, which had been as high as £14,000,000 in 1924 and £9,000,000 in 1925, were reduced at the end of 1926 to no more than £380,400. The specific purpose for which the General Council had consented to prolong for a time the life of the Gold Discount Bank appeared to have been achieved. The German banks were now in a position to furnish an adequate supply of credit for foreign trade. The necessity of continuing the Gold Discount Bank for that purpose had passed. Once more the road lay open to final liquidation. The occasion was frustrated by a new and unexpected extension of the functions of the Gold Discount Bank on which it appears desirable to offer a few observations.

#### Agricultural Credits.

14. The first of the new activities to which the Gold Discount Bank was called was to take over in 1926 RM. 220,750,000 of the 3 to 5 year Agricultural Mortgage Bonds of the Rentenbank-Kredit-Anstalt. It is not to be supposed that in effect this transaction placed that amount of fresh funds at the



disposal of Agriculture. A large portion of the proceeds was utilized to refund part of RM. 293,000,000 of Agricultural credits maturing on November 30, 1926. The rate was fixed at 7 %, which was well below the rate current at that time.

15. The general effect of the operation may be pronounced wholly salutary in so far as it tended to lower the rate of interest for long term loans, and to re-establish the German market instead of the foreign market as the main source of supply for borrowers on capital account.

16. The success which attended this measure should not be allowed to obscure the objections to its repetition. Leadership in times of emergency is expected of Central Banks, but the leadership should be exercised direct and not through the medium of an agent bank which may be acting in competition with private and joint stock banks. The emergency it was designed to tide over has happily passed. Seven per cent mortgage bonds (Pfandbriefe) are now quoted at 102 to 103 and five per cent Pfandbriefe at about 92. Agriculture credit is now in line with long term credit generally. The intervention of the Gold Discount Bank is no longer required and should not be repeated. The supply of credit for agriculture, as an argument for the maintenance of the Gold Discount Bank, has lost whatever validity it may formerly have had.

#### Solawechsel.

17. The second new activity of the Gold Discount Bank dates from December 1926. While the rates for long term money, as mentioned above, were gradually approximating to those of markets



abroad, the short term money market threatened to become redundant. Speculation on the Stock Exchange was rife and the Reichsbank, owing to the scantiness of its portfolio, was powerless to adopt the usual procedure of contracting credit by the sale of its bills. An endeavour was made to produce a similar result through the agency of the Gold Discount Bank which sold Rs. 72,600,000 of its own Solawechsel at rates varying from  $4\frac{1}{2}$  to  $4\frac{3}{4}$  %. They matured in March 1926 when they were repaid with the exception of Rm. 50,000,000 purchased by the Verkehrs-Kredit-Bank, which, at the request of the latter, were renewed. A second issue of Rm. 20,500,000 was made in January maturing in April 1927. It may be noted further that on March 7, 1927, about Rm. 13,500,000 of Solawechsel were under rediscount from the market at the Reichsbank.

18. The undertaking by the Reichsbank to re-discount the Solawechsel of the Gold Discount Bank was reported to the General Council at their meeting on March 28, 1927. A protest was immediately lodged on the ground that the Solawechsel of the Gold Discount Bank were of the nature of financial bills. They could not properly be regarded as bills "relating to bonafide commercial transactions or to goods" as stipulated for in Article 21 para. 2 of the Bank Law and were not therefore available for rediscount by the Reichsbank. The course of discussion brought to light a difference of opinion on this point but, on an explicit assurance by the President of the Reichsbank that these Solawechsel would not be re-discounted in future, it became unnecessary to press the matter further at that time.



19. The question remains whether, apart from the legal considerations to which we have referred, the transaction can be justified as being in accord with central banking practice. In so far as the Bank was exchanging its three months' Solawechsel for 3 to 5 year agricultural bonds it was lending "long" and borrowing "short", a practice abhorrent to sound central banking. But we need not labour that point now. It may be admitted for the moment, that, on the hypothesis that the Gold Discount Bank is a separate and independent banking institution and that Solawechsel are good delivery under Article 21, there could be no objection on that score. But, as has already been shown, the facts are the reverse of this. The validity of the Solawechsel has been called in question and the Gold Discount Bank, far from being separate from the Reichsbank, is in fact identified with it. It is clear that, if justification for the transaction is to be found, it must be sought not in the Law or in central banking practice, but in the emergency conditions it was devised to meet. What were these conditions? The money market had got out of hand and, with only a limited portfolio of bills of its own and no Treasury bills of the Reich available, the Reichsbank had no other means of control open to it than to create substitute bills in the form of Solawechsel of the Gold Discount Bank.

20. Since then the situation has undergone a change for the better in two respects. The official bank rate is now in close contact with the market rate and further control is no longer required. Secondly, the Reichsbank has been able to increase substantially its holding of bills and may reasonably look to the future for a supply of Reich Treasury bills which would probably have been available now but for the recent issue by the Government



of an internal loan of RM, 500,000,000. It will no longer be necessary to secure control by the creation of substitute bills or to continue the Gold Discount Bank for this purpose.

Public Deposits.

21. We now pass to the third and by far the most important new activity of the Gold Discount Bank - the custody of public or quasi-public funds. The subject bristles with difficulty but the details are familiar to the General Council and all we need do here is to refer to one or more of the salient and essential features of a problem which still awaits solution.

22. The Reichsbank is the government bank and, as such, is entrusted by law "with all banking business concerning the general administration of the Reich". The Reich and its Departments have from time to time large surplus funds at their disposal and are not unnaturally anxious to obtain interest on them. But the Reichsbank is not permitted by law to pay interest on deposits since that would be incompatible with the effective control of currency and credit for which it is responsible. Here in a word is the crux of the whole question. The Reich or more particularly the Departments of the Reich ask for interest which the Reichsbank cannot legally pay, and, as a device for getting round the law, the Gold Discount Bank is substituted for the Reichsbank as the custodian of government deposits on which interest is paid.

23. On this point we may observe shortly that the power of the Central Bank to withdraw funds from the market or to release them



at its discretion is essential to an effective control of currency and credit. The difficulty of making control effective would be greatly increased if the Central Bank were obliged like ordinary banks to place funds on the market, without regard to the monetary conditions of the time, in order to earn the interest it pays to its depositors. Whether it does so direct or through the intermediary of a subsidiary like the Gold Discount Bank makes no difference. *Quid facit per alterum facit per se*. It is true that the Gold Discount Bank can exercise a wider latitude than the Reichsbank in its long term investments (cf. para 15) but the limits to this class of business are narrowly fixed for deposit banks. As for the various short money markets, they are tending to become more mobile and it is doubtful if any considerable volume of funds could now be forced into one without causing a compensating outward flow of funds into another. It may not be irrelevant to point out here that the Gold Discount Bank, which was originally created to finance foreign trade, is now an active competitor in the home market and, not content with the issue of credits in Dollars and Sterling, is now granting them in Reichsmarks as well.

24. A settlement of the problem involved in the administration of the public funds is urgently needed, not only because of their influence on the money market but also for other reasons which it is unnecessary to discuss here. But we cannot forbear the remark that by the recent issue of an internal loan, the Reich lost a favourable opportunity of providing in the shape of Treasury bills a highly liquid short term investment for Railway and other public



funds. Pending the time when obligations of this kind may be offered on the German market, and without attempting to propose even in outline a plan for solving the problem, it may not be out of place to note here that the supply of bills is steadily increasing, that the Gold Discount Bank's investments include bills of both long and short maturity which are suitable for purchase on public account, and that the Reichsbank's portfolio is the largest in many months. Consistent administration of the public funds according to a plan in conformity with Reichsbank policy is clearly required, but if the Reichsbank is to fulfil its obligations in regulating currency and the general conditions of credit, it cannot guarantee a fixed return on these funds. Whether the guarantee comes from the Reichsbank directly or from its subsidiary, the Gold Discount Bank is, as we have already mentioned, a purely technical matter and makes no difference in fact or principle.

#### General Conclusions.

25. We may now proceed to state the general conclusions to which we have been led in the course of the preceding survey.

There is nothing in the Plan which indicates that its authors expected the Gold Discount Bank to remain in business or to extend its functions. Its implications, which find support in a direct statement in a letter from the Reichsbank Organisation Committee to the Reparations Commission, looked instead toward its prompt liquidation. But it is recognised that under the extraordinary conditions of financial reconstruction which have prevailed in the last three years, it was not out of order that all reasonable



means should be employed to make the transition as speedy and simple as possible. The Gold Discount Bank proved itself to be a highly useful instrument during a difficult period. Consequently, it is desired if possible to lift the discussion of the future of the Gold Discount Bank out of the plane of prior commitment, whatever it may have been, and to place it on the broader ground of central banking principle.

The Plan, both in the Report of the Experts and in the laws passed in accordance with it, placed about the Reichsbank the safeguards and gave it the responsibilities essential to the conduct of a central bank. These safeguards and responsibilities were expressed not only in general terms but in precise detail, and the detailed prescriptions are to be found not only in the Report of the Experts, but in the communications of the Reichsbank Organisation Committee to the Reparations Commission and in the Bank Law itself. The Bank Law constitutes the charter of the Reichsbank, and what is not there contained is ultra vires for the Bank; and what is there forbidden is definitely prohibited to the Bank, acting either by itself or through one of its exclusive instruments.

The separate existence of the Gold Discount Bank as a corporation distinct from the Reichsbank is technical rather than actual. The Gold Discount Bank is the Reichsbank's exclusive instrument and in carrying out the intents and purposes of the Reichsbank it has the practical quality of a department of the Reichsbank. Not only is the Reichsbank its sole owner, but the two directorates are interlocking, the management is identical, and even the offices of the Gold Discount Bank are in the building of



the Reichsbank. The convenience of the arrangement is undeniable, and under colour of it the Reichsbank administration has performed functions which are forbidden to it acting in its own person. Each one of the three principal functions exercised by the Gold Discount Bank, to which we have referred above, would in whole or in part be impossible of performance in the name of the Reichsbank itself. Indeed, the facility with which the Reichsbank can do things through the Gold Discount Bank, which it would be restrained from doing directly, furnishes the main motive for the retention of the Gold Discount Bank as an operating instrument.

The real identity of the two institutions opens the way not to action within the law but to evasion of the law. The Reichsbank is limited to a sphere of business deliberately and carefully defined and it cannot employ an instrument which is de facto substantially identical with itself, or, alternatively, is wholly and exclusively its subordinate agency, to accomplish purposes which are forbidden to the Reichsbank by the Bank Law or unauthorised by that Law. Any contrary conclusion renders all restrictions of the Bank Law purely illusory and would leave the Reichsbank more free to carry on business in accordance with its unbounded and changing discretion than it was prior to the Experts' Plan and the carefully conceived law of August 30, 1924. Furthermore, the fundamental obligations of the Reichsbank as a central bank are no less operative than the law itself to debar it from the continued exercise of extra-legal functions through the medium of a subsidiary.



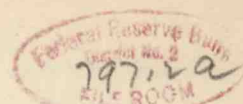
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If, as Dr. Schacht stated in his memorandum to the General Council, dated March 11, 1927, the existing Bank Law does not give the Reichsbank the necessary control of the internal credit situation, and if such control be desirable for the Central Bank, then the remedy is through an appropriate amendment to the Bank Law duly passed through the proper channels and not by the employment of a substitute in the shape of a subsidiary and wholly controlled corporation.

C. S. ADDIS.

London, May 15, 1927.

Referred to in letter of 11/14/27  
also Gilbert ltr 10/26/27  
" Strong " 11/5/27  
to Gov. Young, Owen Young, Ogden Mills



no 3.

THE AGENT GENERAL FOR REPARATION PAYMENTS.

BERLIN, October 20, 1927.

FROM: The Agent General for Reparation Payments,  
TO : The Finance Minister of the Reich.

My dear Mr Minister:

I am sending you herewith, in accordance with our understanding, a memorandum under this date which I have prepared for the German Government, for the purpose of drawing attention to the present tendencies of public finance and credit policy and to the dangers which they seem to involve for the German economy, as well as for the execution of the Experts' Plan. In view of its general nature, I am also giving copies of the memorandum to the Chancellor of the Reich and to the Minister of Foreign Affairs.

I shall, of course, hold myself at your disposal for further conversations, in case you should wish, after reading the memorandum, to talk it over personally with me.

I am, my dear Mr Minister,

Respectfully yours,

(signed) S. PARKER GILBERT

Agent General for Reparation Payments.

1 encl.



THE AGENT GENERAL FOR REPARATION PAYMENTS.

BERLIN, October 20, 1927.

MEMORANDUM FOR THE GERMAN GOVERNMENT.

I am presenting this memorandum for the purpose of calling attention to the dangers involved in the present economic situation, in the hope that by doing so fully and frankly at this time I may render some service to the German Government and to the German economy, as well as to the international situation generally.

I approach the problem from the standpoint adopted by the Experts' Plan, and reiterated in the conclusion to my last Report, "that what is in the interest of the German economy is also in the interest of the execution of the Plan".

In considering the interests of the German economy, I should assume that the general aim of Germany, as of other modern industrial states, would be the continuous development of industry and commerce, both domestic and foreign, with a view to the gradual improvement of the standard of living of her people. For this the most favorable conditions internally would seem to be the constant cheapening of production, accompanied by such increase of wages as cheapened production will permit and as will neither increase prices nor the cost of living. Stable

prices particularly favor stable trade. But the development of industry and commerce also requires a steady supply of new capital, based on savings at home or borrowings abroad; and under prevailing conditions in Germany there is need not only for the creation of new capital, but also for the rebuilding of the old liquid capital destroyed by the war and lost by inflation. In Germany, therefore, there is a special need and a special incentive for saving, and for careful spending as well. Under these conditions, sound and well-ordered public finance, which underlies the whole economic life, is of the utmost importance.

From the standpoint of the execution of the Experts' Plan, I accept at full value the often-repeated assurances of the German Government that its settled policy is to do everything within its power to fulfil the obligations it has undertaken. The aim of the Plan was to put the problem of reparation to the test of practical experience, under a programme which, as the Experts said, "adjusts itself to realities". It is fundamental to this conception that the German Government should permit the Plan to have a fair test, and, while the test is in progress, that the German Government itself should exercise prudence in the management of its affairs.

Recent developments in public finance do not appear to be in the interests either of German economic life or of the execution of the Experts' Plan. The evidences, in fact, are accumulating on every side, and more rapidly within recent months, that the German public authorities are developing and executing constantly enlarging programmes of expenditure



and of borrowing, with but little regard to the financial consequences of their actions. The rising level of public expenditure is already giving an artificial stimulus to economic life, and it threatens to undermine the essential stability of the public finances. If present tendencies are allowed to continue unchecked, the consequence is almost certain to be serious economic reaction and depression, and a severe shock to German credit, at home and abroad.

The remedies consist primarily in reversing the present tendencies toward over-spending and over-borrowing, and applying instead a regime of strict economy and of ordered public finance. These are remedies which lie largely in the hands of the German Government, and, if they will act promptly and effectively, the Reich and the other public authorities still have it in their power to prevent a crisis. The economic situation, though it is already showing signs of tension, does not seem as yet to have developed points of immediate danger. Moreover, some of the new expenditures that threaten the most far-reaching consequences are still only in the stage of discussion, and have not yet been authorized by law.

In presenting this memorandum, it is unnecessary to go much into detail. Each of my public Reports as Agent General for Reparation Payments has pointed to various sources of danger that seemed to me to have appeared from time to time; and my last Report, dated June 10, 1927, warned particularly against the tendencies of budgetary and credit policy. I have also had numerous conversations on these subjects with the Minister of Finance, the President of the Reichsbank, and, less frequently, with the

Chancellor of the Reich. In the following pages, I shall endeavour to bring matters up-to-date, with a review of recent events in public finance and credit policy, and to indicate the relation of these events to the economic situation in Germany, as well as to the execution of the Experts' Plan.

#### I. The Financial Policy of the Reich.

In my Report of June 10, 1927, I made the following general observations on the German budget :

"The point that stands out most clearly in the budgets of the Reich is the constantly mounting level of expenditure. The problem of checking the rising tide of Government expenditures has, in fact, become acute, and it requires the closest attention, not merely from the standpoint of the Experts' Plan but in the interests of the German economy as a whole. At the same time, it is clear that the essential stability of the German budget remains unimpaired, and that the problems presented by the budget should yield readily enough to a steady application of sound principles of budget-making."

The upward tendency of the expenditures and commitments of the Reich clearly appears from the following summary of recent events.

On December 17, 1926, the Reichstag voted a supplementary budget for the financial year 1926-27. This added about 1,000 million reichsmarks to the expenditures originally authorized for that year, bringing them up to a total of 8,543 millions.

On January 5, 1927, the draft budget for 1927-28 was submitted to the Reichstag, carrying estimated expenditures of about 8,525 million reichsmarks.



On February 16, 1927, the Finance Minister made his budget speech in the Reichstag, outlining the financial position of the Government. With regard to budget policy, the Minister said :

"We must arrange to get along with what we have even if we have to postpone and reduce expenditures for things which are desirable and useful \*\*\*\*\* Our burdens are so great that we must take advantage of every opportunity to save \*\*\*\*\*Our tasks during the next few years will be very difficult and bitter\*\*\* Years of restriction and struggle are facing us."

With regard to administrative reforms he said:

"A definitive financial settlement (between the Reich and the States and communes) pre-supposes not only a rationalized State administrative system, but also a private economic system which is not shaken by crises."

With regard to reparation payments, he referred first to the agreement made last year for the settlement of the supplementary budget contributions, and then said :

"I look into the future with grave anxiety. Under the Dawes agreement our payments out of the budget and for the service of Railway bonds and for the service of Industrial Debentures will increase next year a further 432 million marks, and in 1929 and onwards by a still further 290 million marks. At the present moment, in spite of the best will, I see no possibility of providing these sums, to which there will be added, beginning in 1929, supplemental payments on the basis of the index of prosperity \*\*\*\*\*Germany will continue to do everything in her power in order loyally to fulfil the obligations she has assumed, but to this end she must be furnished with the necessary pre-requisites\*\*\*\*\*For us the pre-requisite for the execution of the Dawes agreement is the strengthening of our economic life."

In the same speech, the Minister went on to propose that during the financial year 1927-28 further expenditures should be incurred by raising official salaries "to the extent of what is financially possible"; and he referred also to the importance of indemnifying those who had lost their

private property abroad in the war.

Following the Finance Minister's budget speech, the tendency of the Government's policy seems to have been in the direction of increased expenditure and enlarged commitments.

In spite of the necessity for economy urged by the Minister, the authorizations of expenditures carried in the 1927-28 budget were increased by 600 million reichsmarks before its final enactment on April 14, 1927. The only important reduction was one of about 45 millions in the appropriation for canal and other new constructions. Taking the so-called ordinary and extraordinary budgets together, the total expenditures authorized amounted to 9,130 million reichsmarks, as compared with estimated expenditures of 8,543 millions in 1926-27 and actual expenditures of 7,444 millions in 1925-26, - an increase of nearly 1,700 million reichsmarks in the two years. Of this increase, about 540 million reichsmarks were for reparation payments under the Experts' Plan, with 67 millions additional as a reserve fund for the controlled revenues. Both the 1926-27 and 1927-28 budgets showed an excess of current expenditures over current revenues, amounting to over 850 million reichsmarks in each year. To cover the 1927-28 deficit, the budget authorized loans of 466 millions and appropriated 390 millions from surplus and reserve funds. It also left undisturbed outstanding authorizations to borrow to the amount of 571 million reichsmarks, to cover outstanding extraordinary expenditures for 1926-27.

In the midst of the budget discussions, on March 14, 1927, the Finance Minister of the Reich appeared before the Taxation Committee of the Reichstag to urge the passage of a draft law postponing for a further two



years the definitive settlement of the financial relations between the Reich and the States and communes, and providing in the meantime for increased guaranties by the Reich to the States and communes. On March 17, 1927, I addressed a letter to the Finance Minister of the Reich, pointing out a number of considerations suggested by the Government's proposals and emphasizing their importance in connection with the fulfilment of the international obligations of Germany under the Experts' Plan, not merely as regards the immediate present but more especially as regards the future. On April 9, 1927, the law was passed, substantially in accordance with the Finance Minister's recommendations, with results for the public finances that I have already summarized in my Report of June 10, 1927. The Government of the Reich in the meantime had made another important concession to the States and communes, by agreeing to assume, as from April 1, 1927, practically the entire responsibility for advancing, when necessary, the supplementary funds required for purposes of unemployment relief beyond those furnished by employers and employees, though up to that time the States and communes had been obliged to furnish five-ninths of these supplements.

The present financial settlement between the Reich and the States and communes cannot be considered a provident arrangement for the Reich; and it is open, as pointed out in my last Report, to fundamental objections of principle. These criticisms are fully confirmed by recent events. The States and communes are now drawing larger payments from the Reich than ever before, and will get the principal benefits from any increased revenues that the Reich may collect from the income, corporation and turnover taxes in excess of the amount required to fulfil the guaranty already given. At

the same time, the responsibility for taxation and public expenditure seems to become more and more confused. Notwithstanding their increased transfers from the Reich, the States and communes are pressing new demands for still larger payments to meet their constantly increasing expenditures, and the Reich itself has added to the confusion by bringing forward new proposals for expenditure which still further burden the budgets of the States and communes.

After the adoption of the 1927-28 budget, the question of increasing the salaries of officials became active, and when the Reichstag adjourned in July it was understood that increases of about 10 per cent were under consideration. But, on September 11, 1927, before a meeting of Government officials at Magdeburg, the Minister of Finance announced that he had suggested and the Cabinet had approved "a considerable increase in the rate at first contemplated". The rates of increase, he said, would vary from 18 to 25 per cent, and the total cost to the Reich would be 325 millions annually, of which 155 millions would be for salaries and 170 millions for pensions and similar allowances. It is generally assumed that the States and communes, the Postal Service and the Railway will all make much the same increases. The total cost is variously estimated at from 1,200 to 1,500 million reichsmarks annually. To provide for the additional expenses which the action of the Reich throws upon them, the States are already insisting that increased transfers of revenue from the Reich will be necessary. As for the Reich itself, it appears from the discussion before the Reichsrat on October 13, 1927, that in the opinion of the Finance Ministry the Reich will be able to meet the costs of the salary increases in its own services during the coming year only if its hopes for an increase in tax receipts are realized.



The salary proposals of the Government are noteworthy, not merely because of the large expense which they entail, but even more because they have been made on the most sweeping basis, and in the way most likely to bring serious consequences for the general economy of the country. They are apparently intended to apply quite as much to pensioners and retired officials as to officials on the active list, while even for the active officials they appear to contemplate a general increase in salaries, without any effective attempt at administrative reform.

It is not for me to express an opinion on the merits of the salary proposals, but it would seem as if the German Government could have served its own interests better by using such substantial increases as an instrument for securing the reform in administration of which so many announcements have been made in the past two or three years. It may not even now be too late to make the salary increases serve this purpose. But as matters stand at present, they seem likely to hinder rather than to help the cause of administrative reform, and to saddle new and lasting burdens on the already heavily-burdened budgets of the Reich and the other public authorities.

In addition to these general increases in pensions and in the salaries of officials, the Government of the Reich is advancing two other measures which seem likely to involve large new expenditures, one, the proposal to compensate German nationals for loss or damage to private property during the war, and the other, a general school law for the Reich. Neither of these measures has as yet been enacted into law. The first of them, the draft law for indemnifying German nationals for property lost abroad, apparently contemplates expenditures of about 1,000 million

reichsmarks; but the draft law has not yet been presented to the Reichstag and it is not clear what means of financing are to be adopted or how far the budget is to be burdened with the proposed payments. In this connection, I have already suggested in my letter of August 29, 1927, to the Finance Minister of the Reich, some of the considerations that would be raised from the standpoint of the Experts' Plan by an external offering of preference shares of the German Railway Company; the same considerations, of course, would apply a fortiori to any external loan of the Reich that might be proposed for this purpose.

As for the new school law, no information is available regarding the probable costs, and apparently little consideration has been given as yet to its financial consequences. But it is noteworthy that serious misgivings are being expressed in many quarters in Germany as to the cost of the new law, and that the States and communes have already given warnings that they will not be able to meet the added expense from their own resources and will want more money for the purpose from the Reich. On October 14, 1927, the Reichsrat rejected the draft law for a variety of reasons, after first approving an amendment that would require the Reich to bear all the cost. Since then, the Government has submitted the draft law to the Reichstag, in its original form, with a statement from the Minister of the Interior to the effect that it is immaterial whether the Reich or the States have to bear the cost, because in any event the burden will fall on the German economy. The Government appears to have refrained, however, from making any estimate of the cost of the new law, on the ground that this cannot be done until its provisions are finally determined and the distribution of the cost becomes somewhat clearer.



I do not mention this series of new expenditures and commitments for the purpose of passing judgment on any of them individually. That, indeed, does not fall within the functions of the Agent General for Reparation Payments. The German Government, under the terms of the Plan, is left free to prepare and administer its own budget, and it acts throughout on its own responsibility. This very freedom, however, implies a corresponding responsibility for the natural and probable consequences of its own actions. These, it seems to me, can be summarized briefly, as follows:

1. The Reich, by failing to exercise proper restraint in its expenditures, is endangering the stability of its budget, the establishment and maintenance of which was the cornerstone of the Experts' Plan for the reconstruction of Germany. The situation at the moment is somewhat relieved by increasing revenues and declining unemployment. But any reaction in business would be likely to reduce the revenues of the Reich and increase its liabilities for unemployment relief. In these circumstances, and with increasing reparation payments to face, this does not seem to be the time to burden the budget with new permanent expenditures.

2. With its own expenditures constantly rising, the Reich naturally finds it difficult to induce the States and communes to bring their budgets into proper order, particularly at a time when the measures which the Reich itself

has initiated may add very greatly to their expenditures and throw many of their budgets still further out of balance. The States are already demanding the reopening of the financial settlement for the purpose of securing still larger transfers of revenue from the Reich. And the expected reduction of State and communal real estate taxes which it was announced in April would be one of the conditions of the financial settlement, now appears more and more unlikely of realization, while in some cases, at least, increased local taxation may be necessary.

3. The result is a general lack of effective control over public spending and public borrowing. In consequence, unsound public finance is increasingly prevalent in Germany; and the money which is so badly needed for the development of German agriculture and industry is being absorbed, through taxes and public loans, in a scale of public expenditure which seems to be incurred without regard for the loss of liquid capital which Germany has suffered and the urgent need of recreating this capital through economy and careful spending.

4. Still more broadly, in their effects on economic life, the measures taken by the Reich and other public authorities are tending strongly toward increased costs of production, increased prices and increased cost of living. The result is too negative, in large measure, the



benefits that might be expected to accrue from the process of rationalization which German business and industry have succeeded in carrying out since the stabilization of the currency. The tendency toward higher prices already exists, partly as a result of the high customs duties on imports of many staple products; and it would be greatly stimulated if, as now seems probable, the Government's salary proposals should lead, on the one hand, to demands for similar increases in general business and industry, and, on the other, to increased railroad tariffs, and the like. Manifestly, all these developments tend to raise the costs of production and thus to diminish the capacity of the German economy to compete for export. As the experience of recent months has abundantly shown, they operate also on the other side of the German balance of payments, by greatly stimulating German imports from other countries. Rising internal prices almost always have this effect, and under present conditions the tendency is enhanced by the additional purchasing power which is being placed in the hands of the public by the increasing expenditures of the Reich and the States and communes.

The consequences of Reich financial policy, which have been summarized above, must be considered also in connection with the financial policies of the States and communes, and with the currency and credit policy of the Reichsbank. There is naturally a close relationship between them, and an intimate connection between the results attributable to them.

II. Finances of the States and Communes.

There is little or no current information as to the financial condition of the States and communes, but their demands for additional grants from the Reich and their frequent borrowings at home and abroad indicate that as a whole they are living beyond their means.

The domestic long-term loans of the States, provinces and communes, and of the various public undertakings in which they are interested, have amounted to about 1,000 million reichsmarks since the beginning of 1926, when the domestic market first became available for long-term borrowing. This sum is more than twice the amount of long-term domestic loans placed in the same period by German industry and trade. These various public loans, taken together with the Reich internal loan of 1927, were mainly responsible for overloading the domestic market and bringing about the state of exhaustion which still obtains.

Foreign issues of the States and communes, and their associated public undertakings, have amounted since the beginning of 1925 to the equivalent of about 1,600 million reichsmarks, approximately the same as the foreign loans of German business and industry. Until recently, at least, additional loans appear to have been under negotiation between the States and communes and foreign bankers, up to a total of perhaps a further 1,000 millions. These foreign borrowings have made heavy drafts on the foreign credit of Germany, and those of the States particularly have tended to raise difficult questions under the Treaty of Versailles and the related provisions of the Experts' Plan, as I have already pointed out in my letter of



September 20, 1926, to the Finance Minister of the Reich, with respect to the Prussian external loan of 1926, and my further letter of November 12, 1926, as Chairman of the Trustees of the German External Loan, with respect to both the Prussian and the Hamburg loans.

The foregoing figures for the domestic and foreign loans of the States and communes, amounting altogether to about 2,600 millions, leave out of account entirely their short-term or floating debt. It is impossible from the available figures to make a close estimate of the volume of this debt, but from such casual evidence as has developed it seems already to be very large. In part it represents loans directly obtained from foreign bankers, in part loans obtained from German bankers but from foreign funds borrowed by them, and in part ordinary domestic banking transactions.

The question underlying State and communal borrowing is not whether individual loans should be placed in the domestic market or in the foreign market, or at short or long term, but whether they should be placed at all. To divert the borrowing of the States and communes from one market to the other, or to refuse it in one form and permit it in another, does not go to the root of the difficulty. Over-borrowing at home or abroad proceeds from the same source, namely rising public expenditures, and it is by reducing expenditures to the minimum that relief is to be found. On the other hand, balanced budgets and economical administration will give the best assurance that when credit is needed for essential public purposes it will be forthcoming.

It is recognized, of course, that the Reich does not control the States and communes in these matters. But, when the States and communes

go into foreign markets to finance their budgetary expenditures and internal improvements, they raise fundamental questions of foreign policy which have the most direct interest for the Reich. And under the Constitution itself the Reich has a unique opportunity and even responsibility for leadership, not merely because of its large transfers of revenue to the States and communes but also because of its powers to prescribe the fundamental principles and main outlines of their laws in many matters of taxation and public finance. The force of these considerations has been recognized to some extent in the efforts that have been made for the past two years and more to supervise the foreign borrowings of the States and communes through an advisory organization established for this special purpose. These efforts, for whatever reason, have not been successful, and the results appear in the swollen figures for State and communal borrowings that have already been given. A new and truly effective supervision, based primarily on the principle of controlling public expenditures, is urgently needed at this time, both in the interests of German credit and to safeguard Germany's economic recovery against the dangers of over-stimulation and subsequent reaction as a result of over-spending and over-borrowing by the public authorities.

The German Government's announcement of October 7, 1927, is greatly to be welcomed, not only because it indicates that a revised procedure for supervising the foreign borrowings of the States and communes is under consideration, but also because it points out the sound basis for financial reform by stating that "in view of the entire present situation in Germany any expenditure that is not urgent or economic, whether made



out of foreign loans or from other sources, must be avoided". It is still not clear what practical measures will be taken to apply this fundamental test to the spending policies of the public authorities, but it is of the utmost importance that the Reich should exert a firm leadership in this direction and that its leadership should have the sincere and comprehending support of the States.

### III. Credit and Currency Policy.

The present calendar year has also been one of expansion in the circulation of the currency and in the use of short-term credit, particularly that of the Reichsbank. Any discussion of credit and currency must necessarily center upon the policy of the Reichsbank, which is charged under the Bank Law with the duty of regulating the circulation of money and with providing for the utilization of available capital. But however explicit the law may be, the financial operations of the Reich, the States and the communes have themselves assumed the proportions of a separate credit policy, frequently exercised in opposition to the credit policy of the Reichsbank. In effect, there have been two credit policies, both operating at the same time and one often neutralizing the other. The net result of these different policies, though opposed to each other in origin and purpose, has been in the direction of expansion, as is likely to be the case when the public authorities are on the side of expansion and spending.

The Reichsbank, for its part, reduced its discount rate on January 11, 1927, from 6 to 5 per cent, shortly before the offering of the 5 per cent internal loan of the Reich. The purpose, it was stated at the time,

was to recognize the easier money conditions then prevailing in the German market, and at the same time to diminish the inflow of foreign funds. The results of this policy were discussed at length in my Report of June 10, 1927. For a short period, it will be recalled, the policy achieved its purpose. But by the middle of March foreign funds began again to flow into Germany in large volume, not as long-term loans but in the form of short-term credits, frequently for purely speculative purposes and liable to be withdrawn on short notice. These funds, in turn, provided an additional basis for expansion, and a source of danger for the future. At the same time, the Reichsbank's discount rate became the lowest representative money rate in Germany, and in the first five months of the year, that is to say, up to May 31, 1927, its gold and devisen declined by about 1,000 million reichsmarks, and its holdings of domestic bills rose by about the same amount. In their broader consequences, the forces of expansion thus released gave a further impetus to an already highly speculative stock market, and a further stimulation to an already rising activity of business and a rapidly expanding volume of imports.

During this period, certain measures were attempted, notably in the direction of reducing the volume of stock market credit, but the Reichsbank left its discount rate at 5 per cent until June 10, 1927. It then raised its rate to 6 per cent, but by this time it had lost control of the market and the increase soon proved to be insufficient. The new rate brought no reduction in the volume of Reichsbank credit, and succeeded only during a short period at mid-summer in retarding its month-to-month increase. The expansion which reasserted itself in September brought the



volume of Reichsbank credit and the total German circulation to the highest points since stabilization. The 7 per cent rate fixed on October 4, 1927, recognized this situation and was itself the consequence of events which dated back to the spring.

The financial authorities of the Reich, the States and the communes, by working at cross purposes with the Reichsbank, have made the whole situation more difficult to manage and have contributed to the expansion. The part played by rising budgetary expenditures and borrowings by public authorities, involving heavy drafts on credit both foreign and domestic, has already been discussed. The Reich internal loan of last February, furthermore, was of peculiar importance, not only because it put an end for the time being to the domestic market for new issues, but also because its terms and market price furnished an additional obstacle to a timely revision of the Reichsbank's discount rate. The various steps which have been taken to manage the loan in the market since its issue have been expensive and on the whole ineffective. Another disturbing influence which must be mentioned is the management of the public funds and the public banks, which has been discussed at length in each one of my published Reports. It is unnecessary now to go into detail, but it is clear enough on the facts that the administration of the public funds and the public banks has tended very strongly to diminish the authority of the Reichsbank, and to deprive it of resources which it needed in the general interest of the stability of the German currency and exchange. It has tended, no less directly, to deprive the regular German banking system of its normal resources and to divert great quantities of liquid funds into channels which ran counter to sound credit policy.

The credit policy of the bank of issue and the public finances cannot for long be operated successfully on divergent lines; and there would seem to be every reason, in the general interest, for formulating and putting into effect a definite and comprehensive plan that will assure a properly coordinated policy. The need for the adoption of such a policy, based upon principles of ordered economic growth, and avoiding undue use of credit, is particularly clear under present conditions, in order that the prevailing expansion may not be carried to the point of danger.

#### IV. Conclusion.

I have attempted to bring together in the foregoing pages the accumulating evidences of over-spending and over-borrowing on the part of the German public authorities, and some of the indications of artificial stimulation and over-expansion that are already manifesting themselves. These tendencies, if allowed to continue unchecked, are almost certain, on the one hand, to lead to severe economic reaction and depression, and are likely, on the other, to encourage the impression that Germany is not acting with due regard to her reparation obligations.

Internally, it is evident that an economic crisis would have the most discouraging consequences for the German people, and that it would mean a serious set-back to the reconstruction of German economic life. It is now nearly four years since the first stabilization of the currency, and over three years since the adoption of the Experts' Plan. During this period Germany has made remarkable progress. She has re-established her

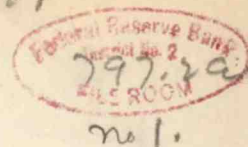


credit at home and abroad, her industries have been reorganized and her productive capacity largely restored, her supplies of raw materials and to some extent her working capital have been replenished, and the general standard of living has greatly improved. This has been achieved primarily through the industry and energy of the German people, but the people of other countries have also co-operated by making their savings available in liberal measure for the rebuilding of the German economy. It would be deplorable if what has been accomplished should now be imperilled by short-sighted and unsound internal policies.

From the standpoint of the Experts' Plan, it is only natural, as I have said, for the creditors of Germany to feel that reasonable prudence in the management of the public finances is a necessary element of goodwill; and it would not be surprising if outside observers should draw the conclusion that the financial policies followed in the past year have not been in the interest of Germany's reparation obligations under the Plan. The payment of the stipulated annuities to the Agent General for Reparation Payments at the Reichsbank constitutes, it is true, "the definitive act of the German Government in meeting its financial obligations under the Plan"; and the payment of these sums is amply secured by the assigned revenues and other specific securities. But the responsibilities of the German Government do not end with the internal payments. The Experts' Plan, though it put the transfer of reparation payments in the hands of the Transfer Committee, recognized clearly that the problem of transfer would depend in large measure upon conditions outside the control of the Committee. It placed a very definite responsibility upon the German Government by providing that "The German Government and the Bank shall undertake to facilitate in every

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referred to in letter of 11/5/27 + 11/4/27



Translation.

THE FINANCE MINISTER  
OF THE REICH

IV a 7229

BERLIN, November 5, 1927.

FROM: The Finance Minister of the Reich

TO : The Agent General for Reparation Payments.

My dear Mr Gilbert,

With reference to my letter IV A 7229 of October 21, 1927, in which I acknowledge the receipt of your memorandum of October 20, 1927, suggested in the course of our conversation at the end of September, 1927, as a basis for further negotiations, I beg to send you herewith, in the name of the Government of the Reich, a reply to this memorandum.

I entirely appreciate your intention to call the attention of the German Government to the dangers which in your opinion may arise to the German economy and the execution of the Experts' Plan through the present tendencies of public finance and credit policy. I recognise in particular that your statements are, in accordance with the Experts' Plan, based upon the view that the furtherance of the German economy serves at the same time the successful execution of the Experts' Plan.

As you will see from the attached reply, the German Government is in entire agreement with you in many points, whereas in regard to other points it is compelled to say that it takes a different view of the present tendencies or regards them as not quite so critical as you do.

With you, I indulge myself in the hope that the exchange of our views will, by throwing light on the difficult questions discussed in it, render a general service.

Looking forward to an early continuation of our oral exchange of ideas,



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I remain, my dear Mr Gilbert,

Yours very sincerely,

(signed) Dr. KOEHLER.

Enclosure: German translation of the memorandum.

THE FINANCE MINISTER  
OF THE REICH.

BERLIN, November 5, 1927.

MEMORANDUM OF THE GOVERNMENT OF THE REICH  
FOR THE AGENT GENERAL FOR REPARATION PAYMENTS.

I n t r o d u c t i o n

The memorandum touches upon a number of most important questions connected with German national life and treats them from economic and financial standpoints. The Agent General for Reparation Payments certainly does not fail to recognize that a large number of these questions have at the same time great political importance; but, for reasons connected with his competence, he refrains from considering this aspect. He has repeatedly pointed out that it is outside the limits of the duties entrusted to him to interfere in internal matters and thereby to assume a responsibility for maintaining in Germany financial order and security, which the Experts' Plan expressly left to Germany herself. The German Government is entirely in agreement with the Agent General in this view; it therefore, in agreement with the Agent General regards the memorandum as the occasion for a frank exchange of opinions arising out of the necessity for the constant cooperation on a basis of mutual confidence which it has always emphasized.

In the following statements it will be attempted, in accordance with the method of the Agent General, to explain the views of the Government of the Reich toward the problems in question primarily from the economic and financial point of view. Such procedure, however, makes it necessary to state that this method of consideration cannot always be complete and cannot always



suffice for the formation of a faultless judgment. Even from the standpoint of the creditor countries, it cannot be a matter of no importance whether the Germany, from which the payments under the Experts' Plan are to be expected is a country full of political excitement and internal unrest because a number of questions of the vital importance of which the German people and its Government are convinced, have not been solved or have been inadequately solved. This view, moreover, is entirely in accord with the fundamental ideas of the Experts' Plan. There is no doubt that there may be dissimilar opinions at home and abroad on the question whether political necessities demand a solution as also in regard to the time and nature of the solution. It is the affair of the Government of a country to find the reconciliation between these divergent opinions. On such a balance depends not least of all a decisive factor in the fulfilment of all international obligations, the will of the nation as a whole. Since the Plan entered into effect, the Government of the Reich has done everything in its power to maintain, for the payments under the Plan, the character of payments agreed upon by treaty, with the result that no payment has been omitted and no obligation has been unfulfilled. To continue the test of the Experts' Plan on the same basis will have to be the aim also of future collaboration between the Government of the Reich and the authorities of the creditor countries. The Government of the Reich considered it necessary to draw attention to the above considerations, which it is convinced are known to the Agent General himself, because the memorandum of the Agent General might in certain places give rise to misunderstandings in the minds of those who are not in a position fully to realise the meaning and the object of the exchange of opinions.

Development and Status of Economic Life.

The memorandum of the Agent General states the dangers which threaten the German economy and the execution of the Experts' Plan as a result of over-spending and over-borrowing by the German public authorities. It considers that the results of this credit policy will be increased costs of production, greater difficulty in the formation of capital, artificial stimulus to economic life and over-expansion as also increases in prices and in the cost of living.

The Government of the Reich is aware that, in view of the peculiar development of Germany during the war and the period of inflation, dangers may arise. For its part, it will use all its strength to meet such dangers. It cannot however attribute the strains apparent in the present economic situation primarily to the reasons enumerated by the Agent General.

Like the Agent General, the Government of the Reich regards it as the aim of its economic policy to develop all productive forces in order to raise the standard of living of the German people and at the same time to enable it to fulfil the obligations incumbent upon it.

The Experts' Plan described the period preceding the beginning of the Reparation year 1928-29, before the normal reparation payments begin, as a breathing space for the restoration of the economy. It also foresaw that this restoration cannot be effected solely out of the savings of the German economy, which accumulate only gradually, but also requires the assistance of foreign credits, especially as the German economy is not freed from reparation payments during the period of restoration, but, on the contrary, larger and larger amounts are being withdrawn from it for payment to the creditor States.



Since the stabilization, the German economy has been working with all its strength to reconstruct itself. The improvement in the economic position thus attained proves that the funds which have flowed into economic life from domestic and foreign sources have been used rationally. The replenishment of the working capital of trade, the renewal of technical apparatus now being carried on, and the extension of plant and the construction of new plant testify to this. This work of reconstruction has also made it possible to re-employ 1.5 million people who were out of work at the beginning of this year. During this period, the German economy has not only extended its apparatus of production and supplied the labour necessary for the increased production, but it has above all satisfied also the needs of the masses who have in turn come back, on the whole, to normal wages. That in addition the efforts to increase exports were successful will be shown later.

The formation of capital within Germany itself is not inconsiderable, as shown by the deposits in the savings offices, for example, and the total deposits in all credit institutions. It has however by no means sufficed; in addition, the inflow of considerable amounts of foreign capital remained necessary.

The Agent General rightly emphasises that the peoples of other countries have cooperated to no small extent by making their savings available in liberal measure, though in the well-understood interests of both sides.

The amount of foreign indebtedness is not disturbing in view of the magnitude of the values given as security and the productivity of the investments made out of it. Insofar as short-term foreign credits have been taken up and are not set off against short-term claims on foreign countries, the anxieties arising out of them will have to be removed by the earliest possible consolidation of these credits. For the short-term indebtedness of

the public authorities, the Government of the Reich is planning a comprehensive consolidation in cooperation with the States and the communes. The Government of the Reich has already taken preparatory steps in this direction with the collaboration of the President of the Reichsbank. The private economy is also making efforts in the same direction.

Foreign credits and loans were naturally followed to a corresponding extent by imports of foreign goods, especially as Germany is largely dependent on foreign products to meet her requirements in raw materials and foodstuffs. The Government of the Reich regards it as a particularly important duty to reduce the necessity of importing foodstuffs by increasing the intensiveness of agriculture. But the solution of this problem requires time and in particular the use of large sums of capital for reducing indebtedness, for technical readjustments and improvements, for agricultural improvements (Meliorationen) and settlement on the land as also for strengthening the position of agricultural laborers. It is at any rate the aim to work toward a reduction in the deficit in the trade balance, by approaching the problem from both sides. There are already indications, moreover, that German industry is on the right road in this respect.

Since July of this year, the surplus of imports of raw materials and semi-finished goods has fallen by an average of 16 % monthly. During the same period, there has been an increase in the surplus of exports of finished goods of about 24 per cent. Even though seasonal influences may to some extent have played a part, this change in direction indicates nevertheless that the German economy is realizing more and more the present limited capacity of the internal market to absorb goods and the necessity of strengthening exports. The Government of the Reich has on many occasions during the last year, called attention to the importance of the latter viewpoint to the work of the German economy.



Germany has been able continuously to increase her exports since the stabilization. The average monthly figures of the net goods trade (reckoned in pre-war values) are: 1924 = 428 million RM; 1925 = 550 million RM; 1926 = 612 million RM; 1927, January to September = 617 million RM; and 1927, September, 692 million RM.

Exports of finished goods alone have increased from 332 in 1924, 394 in 1925 and 423 in 1926 to 446 in 1927. In September, 1927, the amount of exports of finished goods was 502 millions reichsmarks. In order justly to appreciate the significance of these figures, one must remember that this increase was simultaneous with an internal conjuncture and has exceeded the figures which had just been attained during the preceding depression which favored exports. In such a development, extent and speed cannot always be adjusted from the outset to the last degree of expediency. Even if the development has in some places been excessively rapid, as the Agent General thinks he has observed, it has by no means assumed such a considerable extent as would give reason to fear a crisis. The quantity of goods produced has increased relatively more greatly than prices have risen. Furthermore, the price increases of 1927 are due to a considerable extent to the fact that important goods considered in drawing up the index figure have gone up in price on the world market.

In any case, an over-expansion of economic life would be attributable only to a very small degree to measures of the public authorities. Taxes and internal loans create no additional purchasing power; the expenditure of funds procured in this way represents merely a readjustment of existing capital. The foreign loans and foreign credits of the public authorities, however considerable they may be, have, in view of the magnitude of the values involved in the German economy as a whole, at any rate had no decisive importance for

an artificial stimulation of economic activity. For the rest, they have, as explained below, served predominantly productive objects.

The attention of the Government of the Reich is constantly fixed upon the development of trade conditions, in order to ensure the greatest possible uniformity in developments and to enable the maintenance of a stable price-level. In view of the enormous and threatening increase in unemployment, it sought in 1926 to help economic life get over the dead point. As soon then as, in the spring of 1927, an upward movement in the German economy was to be observed the Government of the Reich stopped its measures for providing work and did what it could to retard the rate of speed and the extent of the expenditures of the public authorities. It is at the present time consulting with the Economic Council of the Reich in order to create for the future better legislative and administrative bases for assuring greater reserve on the part of the public authorities in times of trade prosperity. It is well-known that the Government of the Reich is furthering, to the best of its power, the development of statistics and the work of examining into trade conditions because it recognizes their importance to a timely understanding of the symptoms underlying trade conditions and the motive forces of economic life.

The measures to promote exports taken during the past period of trade depression, such as the granting of export credits and export credit insurance, have been developed by the Government of the Reich also during the current year of improved trade conditions, insofar as this was financially possible, because the Government, like the Agent General, places special emphasis on a steadily growing increase of our exports. Its cooperation in the World Economic Conference, in the results of which the German Delegation had a considerable part, is one of its activities in this connection.



The Government of the Reich is working with especial emphasis to complete and to conclude its system of commercial treaties. It may point particularly to the conclusion of the Franco-German and the Germano-Jugo-Slav commercial treaties. It is endeavouring to conclude commercial treaties with Poland and Czecho-Slovakia. In addition, the Government has introduced measures of autonomous reductions of customs rates, in order, also from this side to prevent a rise in the German price-level. Finally, during the past few days, by submitting a proposal in Geneva for the suppression of all export and import prohibitions prejudicial to economic activity, it has shown its readiness to cooperate in the facilitation and reorganization of international trade. As the Agent General himself emphasizes the effect of these measures on Germany's exports depends largely on the extent to which other countries, and especially Germany's chief creditors, show their willingness to follow on their part a commercial policy which opens their markets to German goods in similar manner. Unfortunately, matters are still far from satisfactory in this respect. The most varied obstacles to imports prevent German exports from developing in the way that is absolutely necessary to equalize the German trade balance and in addition to realize the surplus upon which in the long run, according to the Experts' Plan itself, the transfer of reparation payments depends. The German Government observes with grave anxiety this development in the countries constituting its export markets. The German economy is still far from able to meet the deficit in the trade balance out of its own resources. As already remarked, not only is a further and greater growth of exports necessary to achieve this, but above all imports must be restricted by increasing agricultural basic production. But the position of agriculture is characterized by the extraordinary amount of post-war indebtedness, which has increased to a total of RM. 6.7 milliards as a

result of unfavorable economic conditions in the years following the breakdown and the stabilization of the currency. Only a part of this debt, i.e. 2.5 milliards, has been consolidated into long-term real credits. The greater part has been taken up at short-term and there is no possibility of meeting from current revenues debts carried forward from previous years. Accordingly, that portion of the floating debt which cannot be met out of current revenues must therefore be consolidated into long-term real credits. In this process it will not be possible to evade a resort to foreign money in order thus to smoothe the way for a more rational and profitable agricultural output and thus to create the necessary condition precedent to a decrease in the importation of foodstuffs and to a revival of the home market for commercial products and to provide for increased absorption of domestic labor on the labor market.

Not the least important factor in the reconstruction of the German economy is the maintenance and strengthening of German labor. This proves the productive nature of even the increased expenditures for German social policy. The impoverishment caused by war and inflation has caused a disproportionate increase in the number of workers in Germany. Furthermore the German labor market is subject to far greater fluctuations than before the war. For these reasons a systematic labor market policy and an effective unemployment relief have become indispensable today. The weakening of the health and power of resistance of the population, the increase in the number of insured persons and persons in receipt of social annuities as a result of the war, the increased cost of medical relief and the loss of capital suffered by the insurance organizations have called for increased expenditure in respect of social insurance and social relief.



It is furthermore a natural duty of the German people to provide for war-wounded and the survivors of those who fell in the war in such manner as to protect these war-victims from want. In spite of all expenditure thus far only slow progress is being made in eliminating the most urgent shortage of dwellings, as may be seen from the census of dwellings throughout the Reich. Grave danger to the health and morals of the workers and their children is to be feared, and the economy will be prevented from obtaining adequate skilled labor, so long as this housing shortage continues.

The Government of the Reich knows itself to be in agreement with the Experts' Plan in taking all these measures in the field of social relief, for the Plan expressly recognises the necessity of preventing the standard of living of the German population from sinking below the level of other nations.

The greatest part of the observations in the memorandum on the problem of credit and currency policy addresses itself to the Reichsbank, which is directly responsible under the Experts' Plan. The objections made against a credit policy of the public authorities distinct from the credit policy of the Reichsbank may be disposed of by the statement that, in negotiations between the Reichsbank and the authorities in question, an agreement has been reached on a joint leadership of monetary policy, including important matters connected with the investment of public funds. Insofar as this is not yet the case, endeavors are being continued. The Government of the Reich too is of the opinion that any thwarting by other administrations of the currency and credit policy followed by the Reichsbank must be avoided in the interests of the uniformity and effectiveness of Reichsbank policy. As it has done hitherto the Government of the Reich will meet together with the Reichsbank at the briefest possible intervals with a view to keeping the monetary and credit policy in harmony with internal and external policy in general.

Development and Status of the Finances.

I. Fundamental.

The reconstruction of the German private economy required and to some extent still requires, as stated above, measures of an extraordinary nature. The same is true of the reconstruction of the public economy, which neglected most urgent matters, especially during the inflation period, and must make good long-standing omissions. A return to the normal conduct of the public finances presupposes a clear knowledge of the burdens incumbent upon them. The Government of the Reich has been long and most energetically striving to create such clarity. The problem involves the solution of questions connected with the revalorisation, with the compensation to be paid to the war victims who have suffered liquidation and forcible damage, and with the salary reform. Other questions in this connection are the continuation of measures to simplify administrative procedure and the tax system, as well as the collection of statistics on the revenues and expenditures of all the public administrations. The Government of the Reich is pressing for a settlement of these problems in such a sequence of matters as will make it possible at the end to find the definitive financial settlement, i.e., a financial settlement that will not prove ineffective in practice because it is built up on a public economy full of unsolved problems and uncertain burdens. Only thus, through a well-ordered financial administration, can that stability in the conduct of public affairs be guaranteed which will put Germany's private economy in position to produce genuine surpluses.

II. The Finances of the Reich.

1. An account of the general financial position and its development since 1924 was given by the Finance Minister of the Reich in his speech of October 26, 1927, to the Budget Committee of the Reichstag. A printed copy of



this speech is attached. Reference will only be made here to a few figures likely to make clear the actual tendency of development. In the first place, one figure which clearly shows the extent of Germany's financial liabilities. Germany's total war charges, i.e., the reparation payments together with all internal liabilities which the Reich had to assume as direct results of the war, call for over RM 3.5 milliards in 1927, or almost two-thirds of the total ordinary expenditures and more than one-half the total ordinary and extraordinary expenditures of the Reich.

The increase in the total expenditures from 1925 to 1927 is mainly due:

- a) to increased reparation payments,
- b) to the cost of social insurance and unemployment relief,
- c) to assistance to war victims,
- d) to the debt of the Reich.

For these items alone the increase in expenditure amounts to more than RM 1,500 millions, i.e., more than the amount of the increase in total expenditures after deduction of the transfers to the States and communes.

2. Ordinary Budget. - In the ordinary budget approximately 2.6 milliards are required in 1927 for the above-mentioned war burdens alone, insofar as these are a charge on the budget, or approximately half the total ordinary expenditures of the Reich, which without the transfers to the States amount to about RM 5.8 milliards. This does not include the sums which date back to the inflation and became necessary in order to overcome the most urgent distress caused by the collapse of the currency. If we restrict ourselves to the war charges at the amount given, the importance of these burdens becomes clear when it is remembered that for 1913 the cost of the total administration of the Reich was only 2.7 milliard marks. When therefore, in spite of the enormous sum for war charges which did not exist in 1913, the German Reich now

manages with an ordinary budget of RM 5.8 milliards, this can in no case mean budgetary conduct without regard to the reparation obligations. It has already been explained that the increases, insofar as they refer to social outlay, likewise serve to promote the object of economic reconstruction.

The 1928 budget, which alone must carry 400 millions additional for reparation payments, is being compiled on principles of the strictest economy. The Government of the Reich considers it at the present time a paramount duty effectively to oppose continuous increases in expenditure, even in the ordinary budget. For it realizes very well the dangers which an unrestricted rise even in justifiable expenditures would inevitably entail for the budget of the Reich.

3. Extraordinary Expenditures. - So far as the expenditures of the extraordinary budget are concerned, they have been in special measure the subject of the criticism of the Agent General. The Government of the Reich unreservedly agrees that there is indeed, in this extraordinary budget, cause for grave anxiety as to future financial conduct. It does not seem to the Government, however, important at the present moment to raise the more theoretical question as to whether an extraordinary budget as such seems justified or as to whether possible technical faults might be found in the distinction between the two budgets hitherto customary under the special circumstances of Germany. In any case, radical measures are required in order to prevent the borrowings of the Reich from growing still further and to consolidate the existing debt. In regard to the first point, it is the intention of the Government of the Reich to prevent, as far as possible, any increase in borrowing requirements for the new budget year 1928 and to ask for further authorization to borrow, if at all, only to a very small extent and for unavoidable necessities. As to the second question, concerning the



consolidation of existing loan requirements, it must first be remembered that there is at present no prospect of placing loans. On the other hand, some of the expenditures which present loan authorisations are intended to cover are absolutely necessary and have moreover largely been covered by advances from the receipts of the ordinary budget. Under this heading come expenditures which were destined in the past to combat the catastrophic consequences of unemployment and which have found justification in the results already obtained. But meanwhile the task has been undertaken of subjecting the still outstanding part of these expenditures to a careful, critical inspection, and in some cases of entirely abandoning them. Insofar as this is not possible, the only thing left to do is systematically to liquidate the actual programme of expenditures at such reduced speed that it is brought into harmony with the financial position and the capital market. As was already done in the present budget year in relation to the previous fiscal year, the total remaining after the above-mentioned inspection will be taken over into the 1928 budget. Even this, however, will not mean that the funds will be actually expended in full in 1928; the contemplated retardation will, on the contrary, have to extend over a longer period. If these proposals are successfully and calmly carried out, the period of high extraordinary expenditures, the explanation of which lies mainly in the stabilization crisis, may be looked upon as closed.

### III. The Finances of the States and communes.

The judgment of the public financial administration of the States and communes is very specially difficult for anybody who does not have the historical development clearly before his eyes, not only on account of the special duties imposed on these bodies by the war and post-war periods, but also because the German communal system has always been entrusted with

special duties of a private economic nature. The Government of the Reich agrees with the Agent General that the contracting of loans for administrative purposes by the States and communes entirely forbids itself on the home market, owing to the shortage of money, and also on the foreign market because of the extreme caution necessary. It is inherent in autonomous administration that here and there expenditures are unavoidable which are not in keeping with the law of strictest economy. Such expenditures are certainly regrettable. But they represent no considerable magnitude as compared with total expenditures. The duties of the communes are not confined to administration. In contrast to other countries, the communal system in Germany, in particular during the last third of the 19th century, developed in such a way that the communes became responsible in not inconsiderable measure for the satisfaction of certain needs of the private economy. This applies primarily to the establishment and adequate administration of the public utilities. As opposed to countries in which even in earlier years sufficient private capital was available, the supply of the population with gas, water, electric light and the means of transportation necessary for the public has for decades been, to a very large degree, practically placed in the hands of the German communes. No proof is needed of the fact that loans which serve the necessary development and rationalisation of these services are productive in the broadest sense, in so far as in this way private enterprise in the commune is enabled to undertake new and fruitful activity. On the other hand, in making these productive expenditures and in considering the borrowing desired to finance them, the communes must of course give due consideration to the general situation in the German Reich. In the opinion of the Government of the German Reich, it would be entirely improper if a commune should try to proceed in such matters on the basis of its own interests and without regard



for the general currency and credit conditions of Germany. The measures which the Government of the Reich has taken, in connection with the borrowing policies of the States and communes, are explained elsewhere.

A detailed enquiry into the loans contracted by the German public corporations shows that the figures publicly discussed do not justify the conclusions frequently drawn from them in regard to the financial conduct of these corporations. In spite of the fact that if, for example, as is done also in the memorandum, the external loans of the public corporations of Germany since 1925 are estimated at 1,600 millions and the conclusion is drawn that the public administrations have contracted as many loans as trade and industry, an exact enquiry into the loans and the purposes for which they were contracted shows the following picture:

In the period from January 1, 1925, to September 30, 1927, the Advisory Office dealt with the following external loans:

	<u>Applications</u>	<u>Recommendations</u>
a) Communal loans	1,076,778,420	584,965,200 RM
b) State loans	605,808,000	550,500,000 RM
c) Agricultural loans (Rentenbank-Kreditanstalt)	241,000,000	241,000,000 RM
d) Industrial loans (with State or Communal guarantee)	262,008,750	253,608,750 RM
	<u>2,185,595,170</u>	<u>1,630,073,950 RM</u>

This survey shows that the total of 1,600 millions mentioned for public loans includes those of the Rentenbank-Kreditanstalt, i.e., credits borrowed for agriculture which alone total 241 millions and likewise credits for private industrial concerns to the amount of approximately 254 millions. This makes it necessary at once to deduct about one-half milliard from the 1.6 milliard. It may be pointed out further that, when making a comparison with figures for

non-public loans, the memorandum leaves agriculture entirely out of account. The comparison requires however a further comprehensive explanation, if the character of the loans contracted is examined in detail. The following tables, showing the objects of the loans with the sums demanded, will make this clear.

In the period from January 1, 1925, to September 30, 1927, the following applications and recommendations were made:

a) <u>Communal loans:</u>		b) <u>State loans:</u>	
	RM.		RM.
<u>Applications:</u>	1,076,778,420	<u>Applications:</u>	605,808,000
<u>Recommendations:</u>	584,965,200	<u>Recommendations:</u>	550,500,000
Distributed as follows:		Distributed as follows:	
Electricity	approx. 193,643,200	Electricity	approx. 173.8
Gas	" 64,663,000	Water (Hamburg)	" 15.5
Water	" 80,147,000	Sea ports	" 200.7
Harbours	" 20,352,000	Land clearance	
Means of transport	" 111,650,000	(land improvements	
Joint loan of the		etc.)	" 99.5
Savings Bank and		Industry	" 50.7
Giro Association	" 96,600,000 *	Miscellaneous	" 10.3
Miscellaneous	" 17,910,000		
	<hr/> 584,965,200		<hr/> 550.5

\* Used chiefly for electricity, gas, and water; distributed among approximately 160 associations of communes.

The above figures show that the recommendations of communal and State loans have been confined exclusively to those the proceeds of which were to be used for productive purposes. This applies also to the relatively small amount of approximately RM 29 millions which is not itemized, but is included under the heading "Miscellaneous". For the most part the loans contracted by the States and communes are intended for purposes similar to those served in the natural course by the loans of industry. The entire 1.6 milliards have therefore benefited the reconstruction of the German economy and have not



served to increase that administrative outlay of the public corporations from which the memorandum expects dangers.

So far, moreover, as concerns the budgets of the States and communes, the memorandum repeats the criticism of the existing financial settlement between these corporations and the Reich. The Government of the Reich feels that for its part too it may at the outset refer to the discussions which have already taken place and to the statements made by the Finance Minister of the Reich in the budget speech of October 26, 1927. Special explanation is, however, required on some points. The Experts' Plan avoids imposing on the Reich definite regulations as to the nature and date of the conclusion of the financial settlement. To show this, reference may be made to the frequently mentioned passage in the Report:

"We do not pretend to be in a position to make detailed recommendations; the subject is a complicated one and involves the consideration of social and political factors many of which have deep roots in historic traditions."

This fundamental idea has lasting justification. It has frequently been explained already that it is impossible to build up a definitive financial settlement on the basis of a national economy not yet rationalized, the capacity of which it is difficult to estimate and the agricultural position of which is continuously unfavorable, in favor of public administrations which are as yet unrationalized. A premature settlement would place upon the Reich permanent sacrifices which it will certainly be possible to avoid in a subsequent solution under normal conditions. When the present shares of the States in the income and corporation taxes are attacked also because they assure to the States a share in the growth of national prosperity, this conception can hardly be said to do entire justice to the historical development of the German finances and the special characteristics of a financial administration such as that imposed on Germany by the Experts' Plan.

When the new constitution was being drafted, the Reich took care to ensure an increase in its financial powers corresponding to the charges it has to bear. Since 1919 it has not ceased to exercise its influence toward making the financial system more uniform and clear. Thus already in 1919 it took over for itself the great personal taxes. It claims the whole of the tax on real and personal property, and in the case of the income tax and corporation income tax it returns to the States only three-quarters of the proceeds which formerly went in full to them and their communes. As the Reich is responsible for the fixed charges of the Experts' Plan, it has to rely to the widest extent on those taxes which are relatively least affected by economic fluctuations (taxes on consumption). This fact was recognised, moreover, when the securities under the Experts' Plan were assigned. There then remains no other way but to leave to the States a considerable part of the taxes which adjust themselves to the ups and downs of economic development, with the result that in good years the States are able to fulfil their cultural and economic duties, whereas in bad years they must restrict their activities, while the Reich continues to pay reparations. Accordingly, if the provisional financial settlement gives due consideration to the necessary security for reparation payments, the Reich would be violating its obligations if it did not take precautions against establishing its financial settlement too hastily on inadequate foundations. The financial statistics necessary for the definitive settlement, as to the importance of which the Government of the Reich entirely shares the Agent General's views, have in the meantime been expedited with the special acceleration consistent with the necessary care. The German financial statistics for the fiscal year 1925 are on the point of completion. The most important part of them, the revenue statistics (taxes), as well as the calculation of the additional requirements of the Reich, the States and communes, are already completed; further publications are



immediately impending. Concurrently with these statistics Germany has compiled the financial statistics for the financial year 1913, 12 years ago. The conclusion of the preparatory statistical work is no less essential than a return to normal economic conditions in order to find a definitive financial settlement which will protect the economic interests of Germany as well as the objects of the Experts' Plan.

It is a natural demand, and one which neither the States nor the independent legislative bodies dispute, that in questions of public finance the Reich should assume the leadership. This also applies in respect of credit policy, particularly insofar as in this connection the relation of Germany to foreign investing countries is concerned. Such leadership will, as was rightly pointed out in the memorandum, be successful only if sincerely and comprehendingly supported by the States and communes. The extent to which the provisions of the German Constitution are applicable here may be left out of discussion in this connection. At any rate the Government of the Reich is devoting its greatest attention to the development of the financial affairs of the States and communes and is taking care that the principles which it considers right for itself are likewise observed by them. Practical proofs of this are afforded by the agreements on the foreign borrowing of States and communes, which have just recently formed the subject of fresh negotiations and the substance of which is known to the Agent General for Reparation Payments. The most recent agreement was based on the decision of the Reich Cabinet of October 7, 1927, already mentioned in the memorandum, which demanded that in view of the entire situation any expenditure that is not urgent or economic, whether made by means of foreign loans or out of internal resources, must be avoided.

Aside from constitutional obstacles, a direct control over the finances of the States and communes for the purpose of examining financial conditions as a whole meets with difficulties originating in the diversity of the public administrations concerned and in the diversity of the economic, political and cultural factors which have to be taken into account. The Government of the Reich recognizes it to be its duty to bring this difficult problem to an early solution which will take into account the well-understood reconstruction and entire interests of Germany.

#### IV. The Pending Bills.

A special word is required by the three Bills in which the Agent General sees a special burden of the Reich budget and an increased pressure on the budgets of the other corporations, namely, the salary reform, the final war damage law and the school law.

1. The salary reform undoubtedly demands not inconsiderable funds; these however are not inconsiderably smaller than is assumed by the public. The amount required annually for the whole body of German officials, including expenditure on the Railway and Postal service, may be estimated at RM 1,250 millions in round figures. This sum will, however, be reached only if the States and communes adopt the Reich settlement in all respects and without exception. Of the total sum, somewhat over RM 300 millions falls to the share of the Reich. But in considering this latter sum it must be remembered that only the smaller part represents salaries of officials proper. The major part, viz., RM 170 millions, is intended for the victims of the war. It is impossible to answer the question of increasing all these payments in the affirmative or negative solely from the standpoint of financial policy. On the contrary, this very question is one in the decision of which quite



different standpoints must have a part. It is a case of protecting a very large section of the German people from the most serious disturbance and of restoring its confidence, partially shaken, in the guardianship of the State. This consideration plays also a special part in the case of war victims. There is no need to draw upon sentimental reasons of a moral obligation and social sympathy to justify the increases for those who were severely disabled through the service of their fatherland. The necessity of the increases over the present admittedly quite inadequate rates of pay is justified by the given political considerations alone. The work of reconstruction must be endangered if the State cannot give the most severely afflicted section of the population even enough to preserve them from need and to secure the standard of living guaranteed by the Experts' Plan and hitherto withheld. The same applies to the officials. Moreover, they are the persons on whom the State has to rely in the execution of its will and whose attitude toward it and its existence is of the greatest importance to the views of the nation in general. All circles of economic life too agree with the Government that there can be no more serious impediment to the work of reconstruction than the decline of German officialdom, renowned for its devotion to duty and its integrity, into a state of unreliability. Germany has every reason to maintain the great asset of an official class. The present bill is nothing more than the fulfilment of promises constantly reiterated by various Governments. The officials have subordinated their urgent needs to the higher standpoints of the national welfare in praiseworthy manner. They cannot reasonably be put off any longer with further promises at a time when the work of reconstruction of the public administration must come to a certain conclusion, when no distress in private economic life is observable in the degree that hitherto existed, and when the state of the public finances permits action. In regard

to the last consideration, it is pointed out that for the current financial year the necessary funds are available as the result of savings arising out of unemployment relief because of the improvement of the German economic situation. For the coming period adequate cover will be provided by the receipts which may be expected from taxation, to which the salary reform will also contribute, and in respect of which details are furnished in the speech of the Reich Finance Minister mentioned several times above. For the States and communes the question lacks uniformity because financial circumstances are not uniform everywhere. It may be emphasized once more that for purposes of salary reform neither an increase in the rates of taxation nor even a rise in the tariff rates of the Reich Postal Service or the German Railway Company is to be expected.

Naturally, a reduction of total requirements for salaries, by measures of reorganization, is kept firmly in mind in connection with the salary bill. Nothing however can be accomplished on these lines if the officials themselves do not collaborate in all necessary measures to this end with the most unselfish devotion to duty and if they are not at any rate to some extent relieved of constant apprehension that their existences are endangered. The Government of the Reich has for a long time been considering, particularly in collaboration with the Reich Commissioner of Economies, a rational development of its administrative apparatus. In these questions of the political structure of Germany, natural developments must not be violently pushed forward nor hindered by undue timidity. Like the Reich, the States and communes will not be able to avoid the pressure of economic development, which necessitates the strict concentration of all forces and the simplification of the structure of these forces in all branches of private and public economic life. There are three goals which were indicated in the Finance



Minister's speech. Firstly, the simplification of the administration of the Reich itself. This has been undertaken on a large scale; the work will be continued unceasingly and in closest collaboration with the Reich Commissioner of Economies. Secondly, the creation of sharp boundary lines where the spheres of the functions of the Reich and the States overlap. Here there are greater difficulties. Since the first days of the stabilization, it has been tried to clear matters up here with a view to avoiding double work. Much has been done in this sense. The creation of a system of unemployment insurance under independent administration, which eliminates such a border area from the dispute over competence, may be recalled. Further work along these lines must be done so that really only those duties fall to the Reich which are functions of the whole German nation or which the single State cannot fulfil at all or only inadequately. The third goal remaining is the simplification of the administrations of the States and communes themselves, among whom valuable endeavors to continue the work in this field are already voluntarily shown. Nor is there any lack of schemes which promise to materialize at an early date. Mention need only be made of the bill for the standardization of taxation, based upon the idea of overcoming the confusion of several tax administrative apparatuses and of having similar transactions performed by a single administrative organ. In the province of supreme administrative jurisdiction also an endeavour is being made to simplify the administration by setting up a Reich Administrative Court. It is naturally the object of the Government of the Reich to attain similar results in other spheres. The necessary steps to this end have already been begun. In view of the entanglement of these things with the constitutional structure of the German Reich, difficulties arise which cannot be thrust aside merely by a reference to financial expediency. Careful preparation is

required to find a solution which will not substitute new and greater difficulties and frictions for those eliminated.

2. Final War Damage Law. - In connection with the final war damage law, no undue claims are to be made either on the capital market or on the taxpayer. Merely insofar as the proposed use of certain assets of the Reich, i.e., primarily the interest on and proceeds of the sale of the preference shares of the German Railway Company, is not sufficient for the purpose, will a call be made on current budget funds for the relatively low balancing amounts. Insofar as special questions of technical finance are concerned here, the Government of the Reich reserves the right of further discussions with the Agent General. As the Agent General is aware, the Bill itself is a consequence of the measures taken by Germany's former enemies and of the provisions of the Treaty of Versailles. Article 297 i required Germany to indemnify her own nationals on account of these measures and in this manner the liquidating countries were released from the obligation to pay compensation. Those whose property was liquidated have been awaiting settlement of their losses since 1919. Wide circles of the German population have become increasingly uneasy at this course of events. To intervene here and to do at least what can be done in accordance with the weak financial resources of the Reich towards settling a fraction of these damages and promoting most essential reconstruction, is an urgent necessity.

3. The School Law. - The costs of the proposed school law play no part at all in the near future. For the first three years there will be no additional charge in any event. After that time, it is a question of practical execution to what extent costs will arise and how great they will be; in any case, this will largely depend upon the financial position of



those public administrations which are to assume the additional costs incurred. There is no good foundation whatever for the exaggerated figures published in this connection.

The school law is a solution to questions which are most intimately bound up with the cultural traditions of the German people - a solution which is assured by the constitution of the Reich and which is especially urgent, since under Article 174, paragraph 1 of the Constitution, the States are unable to reorganize their education system by means of their own legislation until the enactment of this Law.

As regards the effects of the additional expenditure entailed by the three laws, accordingly, the German Government cannot recognize the conclusions of the memorandum. It believes it has made clear that there is no reason to fear in any way a threat to the principle of budgetary equilibrium, which, like the Agent General, it regards as the corner stone of the Experts' Plan. Within the budget, the payment of the reparation charges is more than amply covered by the pledged revenues.

It must not be left unmentioned that the payments involved by the final war damage law and the salary settlement, unlike the reparation payments transferred abroad, do not themselves weaken Germany's capacity to pay the reparation charges. Here there are merely certain temporary readjustments of purchasing power unlikely to have any economic effect on the conformation of German imports or to result in any economically disadvantageous restriction of exports.

In the foregoing the German Government has clearly set out its view of the financial situation and of the probable productivity of the German economy. It remains only to clear up a misunderstanding that appears to exist as to its view, which has never changed. The memorandum mentions the

budget speech of February 16th, in which the Finance Minister of the Reich, referring to the reparation obligations of the next two years, stated that "at the present moment he did not yet see any possibility of our being able to pay these amounts." But the translation in the memorandum reads: "At the present moment ..... I see no possibility of providing these sums." This translation omits to render the word "yet", which according to German linguistic usage has a decisive influence upon the meaning of the sentence. When this faulty translation appeared in the foreign press, steps were taken to correct it by reference to the official Reichstag protocol.

#### Conclusion.

The attitude of the German Government toward the execution of the London Agreement is clear. With the Agent General, it regards the Plan as a means of making a practical test of the solution of the reparation problem. It intends to contribute its part toward a fair test. It is fully aware of the duties and sacrifices involved in doing so. The German Government has acted thus far in this consciousness. Its measures, explained in detail in the foregoing, are intended to serve to promote the construction of a normal national and political system, without which a further successful execution of the Experts' Plan is hardly possible. This aim includes the supreme endeavour to preserve the fundamental pre-requisite of the Plan: equilibrium in the budget of the public administration. After the explanations given, even for the outsider there can be no justification of the impression that "Germany is not acting with due regard to her reparation obligations" and that the "German financial policy of the past year has not been in the interest of the reparation obligations of Germany". In particular, insofar as the cooperation of the Government of the Reich in the work of the Transfer Committee is concerned, from what that Government has done in practice during the last few years



there can be no doubt as to its readiness to aid within the limits of a sound economic and financial policy. The settlement of the Experts' Plan, with its sharp distinction between the internal payment of reparations and their transfer abroad, has been justly regarded by the whole world as the greatest step forward in the reparation question; the positive duties which the Plan places upon the German Government in respect of transfer are precisely delimited in the Plan (Annex VI). The Government of the Reich affirms that it has never artificially restricted the possibilities of transfer; moreover it denies any intention of ever doing so in future. The real tests as to whether a genuine transfer within the meaning of the Plan is possible in the long run are still to come. As the Agent General himself aptly remarks, and as will be seen from the statements of this memorandum, its realisation depends largely on the economic policy of other countries.

The Government of the Reich believes it should not close this memorandum without giving expression to its firm hope that the confidence in the loyal cooperation of all those concerned upon which the Experts' Plan was based will remain the unshaken foundation of future collaboration.

(signed) Dr. KÖHLER

Finance Minister of the Reich.

Members of our organization have asked for our opinion on the transfer question which has been discussed in the press from time to time, and particularly lately, in relation to the Dawes Plan and reparations and the payment of debt service on Germany's external loans.

We think it is not feasible to attempt to incorporate in a memorandum a synopsis of this question. It is, and all along has been, recognized as a very large question and we consider it one which is hardly susceptible of being briefly summarized. We are reciting in this memorandum certain important details in this situation, believing that such a statement may be of general aid, but it should be borne clearly in mind that this recital is in no way intended to be a summary.

Article 248 of the Versailles Treaty places a first charge for reparations payments upon the entire assets and revenues of the German Reich and its constituent states. The enforcement of this charge has been suspended during the operation of the Dawes Plan.

The primary purpose of the Dawes Plan was to restore the credit of Germany both externally and internally and at the same time to permit the largest feasible reparation payments.

The Dawes Plan was made effective by what is known as the London Agreement, executed August, 1924. Under the Plan the Transfer Committee has charge of the transfer of German reparation payments to the creditor powers. S. Parker Gilbert is Agent General for Reparation Payments, and is Chairman of the Transfer Committee.

Under the Dawes Plan reparations payments are made by the German Government to the Transfer Committee, in marks. It is stated in the Plan that reparation payments, in marks, are the definitive act of the German Government in meeting its financial obligations under the Plan. It is clearly understood in the Plan that the duty of transferring marks into exchange for payment to various of Germany's creditors is the duty of the Transfer Committee and not of the German Government; and it may be



noted in this connection that the Transfer Committee shall not purchase exchange in order to make transfers if the stability of the German currency is thereby threatened. It is clear that the Plan itself contemplates that the transfer of the entire amount of reparations from German marks into other currencies may not be possible at all times or to the full extent of such payments, and a system, therefore, is set up whereby accumulated untransferred marks may amount to five billion marks, after which, reparations payments are to be readjusted downward in order not to exceed this amount of untransferred reparations.

In the event of "financial manoeuvres", so called in the plan, either by the Government or by any group for the purpose of preventing such transfers, the Transfer Committee may take such action as may be necessary to defeat such manoeuvres and may waive the five billion mark limit mentioned above. Moreover, the Plan provides that the Government and the Reichbank shall undertake to facilitate in every reasonable way within their power the work of the Committee in making transfers of funds, including such steps as will aid in the control of foreign exchange. This is one of the provisions of the Plan which has been most under discussion.

Another phase of this matter which might be mentioned is that loans to Germany seem to have been distinctly contemplated by the Plan. It is probably not too much to say that loans to Germany by the United States as well as to some extent by Europe were regarded as essential to the successful working out of the Plan.

The two major tasks under the plan are (1), for Germany, by taxation or otherwise, to provide sufficient marks to meet reparations payments as stipulated; and, (2), for the Transfer Committee, with or without the aid of Germany as the case may be, to transfer these mark payments into other currencies for reparation payments. As to the first question, Germany's ability to pay in marks, although we express no opinion we are impressed by the views of certain people, whom we regard highly, that there is no substantial doubt of Germany being able to do so, providing, of course, that the German economy is enabled to function in a more or less normal way.



It has been recognized from the inception of the Dawes Plan that at some time or times during its operation questions would be raised about the transfer of reparations and the payment of Germany's external debt service and that discussions would, or at least might, take place about these questions; but so far as we know, nothing basically new in the Plan is disclosed in the current discussion or anything which might not well have been contemplated at the time the Plan was inaugurated or at any time subsequent thereto.

We believe it has been generally assumed by the Banking fraternity in the United States that regardless of any difference in view as to the technical priority rights of reparations or debt service, from a practical viewpoint, a way would need to be found whereby debt service is paid, unless confidence is to be destroyed and a very critical situation created in all of Europe.

We believe it is inadvisable even to attempt to take any position from a market viewpoint respecting the German securities which are outstanding. There can be little doubt that in this, as in many other situations, there will be times when, from a market viewpoint, the bonds will be either a good purchase or a good sale. We assume it has been generally accepted that securities having the intrinsic merit of various German issues floated in this market only yield the high interest rate which they do because of the political and other considerations involved and because of possible, or even probable, market fluctuations incident thereto. The total amount of German securities which has been floated in this market beginning with the \$110,000,000 of Germany's external 7s is approximately \$1,100,000,000 requiring from the point of view of international debt service and transfers today, a relatively small amount. The loans which we ourselves have originated have been appraised and set up, we believe, with the most meticulous care; and other issues floated in this market, we must assume, have likewise been so handled. Under these assumptions it has been, and continues to be, our belief that the good German dollar loans, and so far as we know, all such loans outstanding in this market will be paid principal and interest.

B. WALKER.



Mr. Roland W. Boyden of Rope, Gray, Boyden & Perkins, who was formerly unofficial representative of the United States on the Reparation Commission, delivered an address before the Academy of Political Science in the City of New York on November 18th. The following is an extract from his address:

"The recent discussion about our advances to Germany have centered about one point in particular. What would happen to our non-government loans to Germany if they come into competition with Germany's reparation obligations? Suppose that some time there should not be enough foreign exchange available, will the use of exchange to meet non-governmental obligations be restricted?

"We have on this point to deal with the powers of the German Government, its obligations under the Treaty of Versailles and the Dawes plan, the powers of the Transfer Committee under the Dawes plan, and the powers of the Reparation Commission under the treaty and the Dawes plan.

"The Transfer Committee has power to make transfers, i.e., to purchase exchange, but only to such extent as in its judgment does not endanger Germany's currency stability. It cannot restrict the purchase or use of foreign exchange by Germans for other purposes. It can, of course, make suggestions to Germany herself and Germany is under a general obligation to co-operate in making reparation transfers possible.

"Germany herself has sovereign power to place legal restrictions on exchange transactions. Such efforts are usually in the long run futile, as well as harmful, and they are now quite out of fashion.

"The Reparation Commission's present powers seem limited to the priority given to reparations by Art. 248 of the Treaty of Versailles which seems limited to the assets and revenues of the Reich and the constituent states. Even this is not strictly a prior lien, but what is technically known as a "floating charge", not applicable when there is no default, and there is in my judgment no likelihood of default, for Germany can certainly pay the marks to the Allies. The fact that reparation payments, after being paid in marks, cannot be transferred is not a

default. There are other features which seem to safeguard Germany's non-governmental obligations against the possible application of Art. 248, but we need not go further.

"This rough analysis of the legal possibilities shows no cause for alarm. But as a matter of fact it is hardly worth while to consider the legal technicalities of the situation. The fundamental safeguard is the obvious fact that it would be financial folly for anyone to place obstacles in the way of providing exchange for the service of these non-governmental loans. Germany's credit is bound up with them. Any failure to meet them would destroy that credit. Reparation payments are dependent on Germany's credit. It took five years after the Armistice to drive this lesson home and make the Dawes plan a reality. It is inconceivable that any government should ever want to learn that lesson over again."

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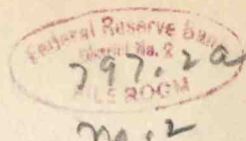
One of the most interesting of the books on the Dawes Plan and Reparations has recently been released. It is "The Dawes Plan and the New Economics" by Geo. P. Auld, formerly Accountant General of the Reparations Commission.

E. Stair.

Nov. 29th, 1927.



Referred to in letter of 11/14/27



TRANSLATION.

SPEECH OF THE FINANCE MINISTER OF THE REICH  
BEFORE THE BUDGET COMMITTEE  
OF THE REICHSTAG ON OCTOBER 26, 1927.

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The introduction of the draft Bill relating to salaries gives me an opportunity of indicating the broad outlines of the general position in regard to the financial policy of the Reich. I cannot do this without glancing at the development of our finances since 1925. I regard it as the more necessary that both at home and abroad apprehension on the score of our tendency towards increased expenditure is being expressed. My object is to explain the factors which have led to this increase in expenditure, and which - I may say at once - have for the greater part shown themselves to be the result of inevitable development.

The development of ordinary and non-recurrent expenditures between 1924 and 1927 is as follows (I base my calculations here for 1924/1926 on the budget results including the outstanding balances and for 1927 on the budget estimate): these expenditures amounted in 1924 to 4.3 milliards, in 1925 to 4.95 milliards, in 1926 5.7 milliards and in 1927 5.76 milliards. This shows that the expenditures increased between 1924 and 1927 by about  $1\frac{1}{2}$  milliard, the most rapid increase being between 1925 and 1926 (about 750 millions). It should be remembered, in connection with this tremendous increase, that 1924 cannot really be taken as a starting point or as a typical year for purposes of comparison. The position was not stable enough at that time for us to be able to regard 1924 as a normal budget year. Moreover, we have since 1924 been labouring under the necessity of making good

what was destroyed during the war and the Inflation. The Reich had recovered from the worst of the economic crisis, and had to devote that year to reconstruction and building up what had been destroyed. In addition, there was the anxiety in regard to the most precious possession left to us - the working capacity of the German people. This work of reconstruction has inevitably led in the last few years to increased expenditure. The draft bills now introduced by the Government of the Reich are part of this work and, only when this development has in some measure been brought to completion, will it be possible to speak of a normal budget which excludes any further increase in expenditure.

I will now, if you will allow me, give a survey of the principal items of increased expenditure in the last few years: the expenditure on social insurance and unemployment relief amounted in 1924 to 165 millions, in the following years to 422 millions and 698 millions respectively; for 1927 it is estimated at 615 millions. That means another tremendous increase in expenditures since 1924. No one can say that, having regard to the economic situation which lies behind us, especially the period of terrible unemployment, this expenditure was unnecessary. Expenditure on interest and sinking fund of the public debt of the Reich amounted in 1924 to 200 millions and increased in the following years to 105 (?), 340 and 486 millions respectively. This represents an increase of nearly 300 millions, which is mainly due to expenditure in respect of loan liquidation. Reparation payments amounted in 1924 to nil, in 1925 to 146 millions, in 1926 to 433 millions and in 1927 to 831 millions - an increase of more than RM 800 millions as compared with 1924. Those are only the budgetary payments; the expenditure on social relief and pensions amounted in 1924 to roughly 1 milliard, and in the following years to 1.4, 1.45 and 1.47 milliards respectively - an increase of



approximately RM 400 millions. These four items of expenditure alone make an increase in the budget charge of about 2 milliards in 1927 as compared with 1924 - an increase which must generally speaking be regarded as inevitable. Against this there is a gradual falling off of internal war charges, which amounted in 1924 to RM 999 millions, and in the next years to only 393, 305 and 176 millions respectively. Let me amplify these figures, which speak for themselves, by one more consideration. If we understand war charges in a rather looser sense - that is, as including, besides the reparation payments and so-called "internal war charges", war and military pensions, expenditure connected with the ceding of territories, the Occupation and disarmament as also other outlay arising out of the war - it is seen that the amounts thus shown in the budget of the Reich in respect of which there are no corresponding items in pre-war budgets make up an extraordinarily high percentage of the total expenditure of the Reich.

The war charges in this sense amount in 1927 to over RM  $3\frac{1}{2}$  milliards, that is rather more than half the total expenditure of the Reich, or RM 57 approximately per head of population. On the other hand, the charge per head of population in respect of the total expenditure of the Reich in 1913 amounted to about M 41, or only about  $\frac{7}{10}$ ths of the expenditure in this financial year in respect of war charges only.

These brief and rough indications are, I think, sufficient to show that the increase in expenditure as compared with before the war and between 1924 and 1927 was and is to a large extent inevitable and in no way points to extravagance. It is admitted that here and there there has been an increase in expenditure which could have been avoided or which cannot be reconciled with principles of extreme economy, but on the whole the increase in expenditure is a result of the war, and, as I have said, determined by the necessity of

reconstructing everything that was destroyed during the war and the Inflation.

We have, particularly during the last few months, undertaken a considerable restriction of expenditure policy in the current financial year and introduced a system of permanent control of expenditure, so that the principles of strictest economy may be meticulously observed. This work of reconstruction discussed above includes the drafts announced by the Government in February of this year and introduced subsequently. I have already pointed out that, with regard to the fact that the salaries of the officials have remained considerably below the salaries before the war in real purchasing power, the consequent distress and debts of the officials which have been increasing from year to year and the resulting dangers to the State, an increase in the rates of remuneration of the officials is incontestably necessary and brooks of no delay. This is not a fresh additional charge but a making good of the failure to increase salaries in the last few years, with a view to maintaining the working capacity, contentment and integrity of the German officials: it is in fact an expenditure on reconstruction of undeniable political importance. In the draft Bill, the economic position has been taken into account, as it had to be. Consequently the Government of the Reich could not publish the draft on April 1 or July 1, 1927. It is this need of taking into account the economic position which has prevented us from introducing the draft at a time when it was not altogether possible, in view of the economic position, to see to what extent expenditures could be covered. If the draft is introduced at a moment when the measures for the simplification of the administration have just been introduced but not yet fully applied, it must be remembered that those measures are only possible with a really vital staff of officials, who are not burdened with anxiety as to how they are to make both ends meet.



The same is true of the final Law for the liquidation of war damages. Here again, it is a duty to make good what had inevitably been omitted in this connection owing to the strained position of the finances and the excessive obligations upon the Reich. I would point out that, according to the Government draft, this will not entail a very great increase in the charges in respect of the current budget, but that the additional expenditure is to be covered by utilisation of property of the Reich. It is quite a mistake when it is represented in foreign countries that a yearly expenditure of RM 1 milliard will be necessitated for this. As a matter of fact, this sum is what is needed to meet the total capital requirements of the country.

If I may be allowed to touch on the subject of the Education Bill, the introduction of such a measure is demanded by the constitution of the Reich and consequently also represents an unavoidable duty. In how far the Education Bill before the Reichstag involves an increase in present charges cannot yet be estimated. It must be the aim and object of us all so to carry out the provisions of the Education Bill as to assure the keeping of any additional expenditure incurred by the public departments concerned within the narrowest possible limits. In any case no increased charges are involved for three years. The question does not therefore arise at all as far as the current budget and the next two financial years are concerned. I would however like to say a word in regard to the over-estimates which have been disquieting public opinion in the last few days, a figure of 600 millions and even more having been mentioned. One may ask why this Bill was introduced in this (current) year of all others and why

1927 should have been burdened with the Bill relating to salaries of officials, the Bill on the liquidation of war damages, and the Education Bill, why the Finanzausgleich had to take place at the beginning of this financial year, why a skeleton law of the Reich had to be issued and why an unemployment insurance Bill has been drawn up - all of which Bills are causing more or less apprehension in the public mind and involve a heavy budget charge. It would have been much pleasanter for me as Finance Minister of the Reich if I had not had to undertake all this work during the current financial year and a distribution of the work could have been effected here also. There has however been no such distribution. On the other hand, we are in the last year of the so-called recuperation period - the year of transition as far as our charges under the Dawes Plan are concerned. The Government of the Reich was of opinion that for all these reasons the matters in question should be dealt with now, in the current financial year.

In regard to the question of cover, I would like to emphasize the fact that the cover for the expenditure involved by the new settlement of the salaries question can be found both in 1927 and 1928 in Germany without any increase in taxation, exclusively by means of economies on the expenditure side and the surplus revenues provided by the taxes (of course without any increase in the tax rates). I would like to consider now the development of the financial position in 1927.

The financial position of the current budget year has, following the upward movement of the conjuncture, developed more favourably than could have been expected when the 1927 budget was established or even when it was



voted in the Spring.

On the revenue side, Income, Corporation and Turnover Taxes etc. amount in the first six months of 1927 to 2 658 millions compared with the budget estimate for the year of 5 306 millions, Customs and taxes on consumption etc. to 1 457 millions as compared with the budget estimate for the year of 2 445 millions. The estimated yearly results may not be calculated by doubling the actual returns for the first half year, as but few taxes are evenly collected throughout the whole year - in the case of most of the taxes a number of circumstances demand that a distinction be made between the amount collected in the second half year and that collected in the first half year. It is therefore necessary to regard the individual taxes.

In regard to the Wages Tax which is estimated for 1927 at 1 200 millions, this yielded about 640 millions in the first half year. The result for the second half of the year may be presumed, on the strength of previous experience, to be influenced by the greater number of unemployed persons and the amounts to be paid as rebate in respect of the tax, between January and March. These reduced receipts will however be set off by increased receipts derived from the increase in wages and salaries already introduced. The returns for the whole financial year may thus be calculated at about 1 270 millions. The Tax on Income derived from Capital deducted at the source (which was estimated for 1927 at 120 millions) yielded 76 millions during the first half of the year. A similar amount is not to be expected for the second half of the year, as the majority of companies draw up their balance-sheets so as to coincide with the calendar year, and pay their dividends in the first half of the financial year. The preliminary estimate will however in any case be attained.

The probable yearly yield of other income tax was estimated at 1 300 millions. About 650 millions were collected in the first half of the financial year. Here again the preliminary estimate will probably be reached. On the other hand, the Corporation Income Tax, which is estimated at 400 millions and brought in 240 millions in the first half year will show a certain surplus.

Only 372 millions approximately were received in the first half year from turnover tax, which was estimated at 900 millions. In this connection however there are two things to be considered. Firstly, the revenue from the Turnover Tax is higher in winter than in summer, on account of the extra Christmas business. Secondly, there is in 1927 a reduction in the actual amount collected and accounted for owing to the fact that on April 1, 1927, the system of quarterly payments was adopted. Thus the turnover for two months is absent in the first half year 1927 in the case of those paying every month. In the total result therefore there will be but a small reduction, if any.

A minimum amount of 2 600 millions is guaranteed to the States as transfers in respect of these taxes. Whether this sum will be actually reached or whether a certain amount will have to be advanced from the guarantee of the Reich is not yet known. In no event however will such an advance, if any, amount to the sum provided for in the preliminary estimate, but will probably amount to only 20 millions.

In the case of the Tax on Real and Personal Property, for which 470 millions was estimated, about 200 millions were received in the first half of the year. It should be remembered in this connection, that the assessment for the Tax on Real and Personal Property in 1927 will not be completed until



November and December and that, on the basis of the assessment, a considerable supplementary payment is to be expected in the case of some of those liable. Further, agriculture, which had no quarterly payments to effect on August 15, only had to pay it on November 15 together with that quarterly instalment. The total returns will therefore be much below the assessed returns. The Succession Duty was estimated at 100 millions. During the first half of the year, about 33 millions were received: that is to say, about as much as in the whole financial year 1926. For the whole financial year 1927, actual returns of 70 - 75 millions may be expected.. That this figure is less than the preliminary estimate is still largely to be attributed to the fact that the tax-payers are short of liquid funds and therefore apply for respite of payment in accordance with the provisions of the law relating thereto, and that these applications are, in view of the position, often not refused.

Of the other Income, Corporation and Turnover Taxes etc., which are not - like the Tax on Landed Property, the Automobile Tax and the Race-betting Tax - merely transfer taxes, a certain not very considerable increase of returns over estimates may be expected in the case of the Company Tax, the Bourse Turnover Tax, the Tax on Insurances and the Transport Tax. The Customs, which were estimated at 890 millions, brought in 628 millions in the first six months. It should be borne in mind however that during this period, as a result of the unfavourable harvest in 1926 and 1927, imports of cereals have been unusually large. It is not to be assumed that imports of cereals and flour will be as great in the second half of the year. The total returns may therefore be estimated at about 1 150 millions.

The tobacco trade has developed satisfactorily during the current year and there has been a considerable increase in output. Whereas the yield

from the Tobacco Tax was estimated at 700 millions for the year, 374 millions were collected in the first six months, and it may be assumed that the estimates will also be exceeded during the latter half of the year. A small surplus may also be expected in the case of the Beer Tax, the yield from which was estimated at 335 millions for the year, whereas roughly 180 millions were collected during the first six months. The deficit in the yield from the Sugar Tax will amount to approximately 75 millions as compared with the budget estimate of 275 millions, in view of the fact that the tax reductions only make themselves felt from October onwards.

Provided that the economic position remains unchanged, surplus net receipts of approximately 300 millions may be expected for the Reich from all sources.

On the expenditures side the most important economies are to be found under expenditure for unemployment relief. The unexpectedly favourable development of the labour market, due to the reduction to 350 000 of the unemployment figure (excluding persons receiving emergency relief) has resulted in an expenditure of only approximately 95 millions for ordinary and emergency relief during the first half-year out of the 450 millions entered in the budget. During the second half of the year, approximately 50 millions will have to be expended to form a foundation for unemployment insurance, whilst an amount larger than that for the first half-year will have to be found for emergency relief. It may nevertheless be assumed that quite 200 millions may be economised. In the spring of the year, when the number of unemployed exceeded 1.8 millions (there were 1 225 000 on March 10), it was not possible to assume this.

The remaining economies effected on the expenditure side of the budget



are balanced by extra-budgetary expenditures and expenditures in excess of the budget. An adjustment of the surplus revenues and minus expenditures therefore leaves an improvement in the probable effective results, as compared with the budget estimates, of roughly 500 millions. Set off against this however are the expenditures to be called for in the supplementary budget, where naturally the amounts required for officials' salaries and compensation to war victims play the chief part. For the rest, I would here refer to two further items of expenditure only: execution of the compensation procedure at present in force in respect of "liquidation" war victims and mitigation of the distress caused by the floods. The total expenditures in the supplementary budget, the final amount of which has not been definitively fixed, would amount to something between 250 and 300 millions.

Even taking the maximum figure of 300 millions, 1927 would still close with a surplus of approximately 200 millions.

There are two points which must not be overlooked, in forming a complete picture of the situation.

Point one refers to the dangerously high extraordinary expenditures. The extraordinary expenditures for 1926 and 1927 which have not yet been covered by loans amount to more than 900 millions, roughly half of which has up to the present been expended and provisionally met out of funds in circulation. This was only possible owing to the fact that the funds in hand and the budget surpluses (which also strengthen the said funds) for covering the outstanding expenditures of the ordinary budget had hitherto permitted this method of covering expenditure. To the increasing extent to

which these funds are assigned to their original purpose, i.e. to cover ordinary expenditures, they must be replaced by other funds: that is to say, the loans provided to cover extraordinary expenditures must be actually taken up. That is however quite impossible at the present juncture owing to the position of the capital market. The high figure of extraordinary expenditures therefore presents a danger which must not be under-estimated, and the extraordinary expenditures of the 1928 budget must therefore be restricted to the lowest figure possible, and that part of the 1926-27 extraordinary budget funds not yet expended must be liquidated (in so far as a further reduction is not possible here also), at least at the speed required by the financial position and the state of the capital market. We must free ourselves from the necessity of taking up such extensive loans.

Point two is the prospect for 1928. Excluding requirements under the Liquidation War Damage Law, the 1928 budget will close with a surplus of approximately 500 millions for the recurrent and non-recurrent expenditures, although 400 millions more have to be paid for Reparation charges. This is however only the preliminary estimate of the Finance Ministry of the Reich which has not yet been approved by the Cabinet.

The chief items of surplus expenditure in 1928 will be the salaries reform and the increased Reparation payments. These main items are however set off by reduced requirements for unemployment and emergency relief as compared with the 1927 estimates. Further the non-recurrent revenues entered for 1927, the surplus from 1926 amounting to 200 millions, the working fund of 190 millions and the net profits from coinage of 145 millions disappear.



It will nevertheless be possible to balance the budget. Provision is made for a strict limitation of expenditures. Moreover the actual yield from taxation during the current year appears to justify the assumption that the total net proceeds for the Reich in 1928 are likely to be roughly 300 millions in excess of the probable actual revenues for 1927. The chief taxes the returns from which are thus assessed at a higher figure are Income Tax, Corporation Income Tax, Tax on Real and Personal Property, and Turnover Tax. In the case of the Income Tax and Corporation Income Tax, the favourable trade conditions of 1927 will make themselves felt to the full extent only in 1928, in view of the final payments resulting from the spring assessment for 1928. The following figures represent the yield from Income and Corporation Income Taxes in the last two years: the Tax on Wages produced 1 367 millions in 1925, 1 095 millions in 1926 and is estimated to produce some 1 270 millions in 1927. The corresponding figures for the Tax on Income derived from Capital are 82, 95 and 120 millions, for the other categories of income tax 803, 1 064 and approximately 1 300 millions, and for the Corporation Income Tax 186, 382 and approximately 450 millions. The point to be noticed here is the considerable increase of the other categories of income tax and the corporation income tax, both absolutely and also in comparison to the Tax on Wages. Even taking into consideration a certain fall in the Tax on Wages, 1928 may be expected to produce 2.9 milliards, (approximately 550 millions from the Corporation Income Tax). In this connection the displacement of the Tax on Wages in its relation to the general position is of great interest. Whereas the Tax on Wages in 1925 was still 300 millions more than the Tax on Income derived from Capital, other categories of income tax and

corporation income tax together, it has since that date steadily fallen off in so far as its proportion to the other taxes is concerned.

Taking the Tax on Real and Personal Property, a higher yield may be expected - more especially in view of the general re-assessment of land site values as at January 1, 1928, which will certainly be higher than the values as at January 1, 1925, which were taken for the assessment of the 1927 tax. In the case of the Turnover Tax, the change to quarterly payments which resulted in a certain falling-off in yield for 1927, will alone provide a corresponding surplus of over 100 millions for 1928. Further, the control of all sources of revenue which had to be suspended for urgent reasons and is of considerable importance will be resumed. The turnover tax is to be entered for 1 050 millions in the 1928 budget. It is true that this figure is based on the assumption that the general economic condition will not change for the worse to any great extent. A severe crisis would affect not only the revenue but also the expenditure side of the budget, more especially the items for emergency and unemployment relief. In the case of Customs and taxes on consumption etc. the probable yield for 1927 will be taken as a basis. Taking the Customs alone, it might perhaps be well to estimate the yield for 1928 at a somewhat lower figure in view of the reduction of Customs rates as a result of (a) the policy of commercial treaties and (b) the intention of the Government to reduce the autonomous Customs rate, which was already notified in the summer. We therefore prefer not to take the annual yield for 1927 as a basis but to count on only 1 050 millions for 1928 for Customs.

The increased estimate of the yield from taxes and dues is not in itself sufficient to balance the budget. This will be possible only if the



balance from seigniorage in 1927 and the balance of the working fund amounting to 62 millions and also the probable surplus from 1927 are entered as revenues to cover expenditures. This presentation of the budget, which can naturally be only a survey in view of the present position of the budget negotiations, indicates that, while there is certainly no fear of a deficit, further charges cannot be assumed. We have established the budget as strictly and economically as we considered permissible. The estimates are cautious, on the assumption that there would be no great prosperity but also no great depression. This being so, the figures have been neither over-estimated nor under-estimated. The whole work of drawing up the estimates is based on the desire to reflect the real position as far as this is possible with such estimates. I followed this course because I particularly did not wish the 1928 budget to be delusive but to reflect the facts as closely as possible. The correctness of these estimates is, as already remarked, conditional upon the economic position of the country not being subjected to extraordinary depression of a catastrophic nature. The national economy developed very favourably during the last six months. This is clear not only from the unemployment figures but from the increased yield from the tax on wages and other taxes in the budget of the Reich. We nevertheless consider that our entire economic position must be carefully observed, for it is only by promoting industry and by striving to cheapen production that Germany can attain success and increase her competitive power. German industry has not yet succeeded in the great competitive race with foreign countries. Trade is flourishing but only at home. When discussing the whole position, we must free ourselves from the idea that home prosperity alone can bring us what

is expected both at home and abroad. The Government of the Reich lays special value on the point that the financial position must not be regarded from the point of view of taxation alone and that the charges on German economy must be discussed in detail in all their effects. The Government of the Reich is therefore of opinion that there can be no question of opening fresh sources of taxation, but that the policy of reducing taxes begun in 1925 must be continued. In 1925 a reduction of  $2\frac{1}{2}$  milliards was effected by means of the great tax reform. In 1926 there was a reduction of half a milliard. Our financial policy must and will aim in the future also at reduced taxes. I have already mentioned the opinion of the Finance Ministry of the Reich on reducing Customs. I presume that the question of taxation will be dealt with in the next few weeks as we shall in any case be obliged to examine this problem in detail in its relation to various legislative measures. The 1928 budget is to reflect the strictest economy. We consider caution in establishing expenditures to be absolutely necessary. An automatic and continued increase in expenditures must in the last instance undermine the stability of our finances with all its attendant drawbacks for the economy as a whole and consequently for the budget of the Reich. The aim of the Government of the Reich to place the finances on a healthy basis is opposed to such a short-sighted expenditure policy.

You will in this connection allow me one more word regarding the relations between the Reich, the States and the communes. The transfers in respect of the chief taxes of the Reich form an important part of the Finanz-ausgleich which to-day plays a decisive part in the relations between the Reich, the States and the communes. Particularly sharp criticism at home and abroad is in many cases making itself heard here. We are frequently



advised to simplify the constitutional structure of the Reich and thus to economise. Under the most difficult circumstances, Germany endeavoured to simplify her constitutional structure as far as possible in the Constitution of Weimar and the legislative enactments for its execution. The increase in the powers of the Reich, in particular in financial matters, under the 1919 Constitution, is evidence of this, as is also the adhesion of various States in the last few years. The force here at work was not external compulsion, but natural economic developments which we are unable artificially to accelerate or artificially to repress. Constitutional policy is in the stage of development in Germany also. The Reich does not watch this development with supine contentment or passive submission. It would be contrary to all historical precedent and at the same time very dangerous from the political point of view if all the States were compulsorily deprived of their independence, merely in order to effect economies the amount of which it is hardly possible at present to estimate. Steps of the kind are bound to bring up a number of other and more difficult questions than that of a more or less considerable saving in the cost of administration. In other States with a Constitution similar to that of Germany the individual life of the separate States is thought to be of great value. Examples of this are the United States and Switzerland. Our efforts in the Reich, States and Communes to obtain the maximum of economy may well be so directed that we carefully promote any development tending towards amalgamation and that the Reich brings pressure to bear for the reduction by the united endeavours of all parties concerned of the total cost of administration. In these efforts the Government of the Reich has never flagged. Three courses are open to it. First comes the simplification of the administration of the Reich itself. This has been undertaken

on a large scale and constant efforts towards simplification are made in very close cooperation with the Economy Commissioner of the Reich. A further point is the clear delimitation of boundaries in cases where the functions of the Reich overlap with those of the States. Here the difficulties are greater. Since the first days of stabilisation attempts have been made to clear matters up so as to avoid overlapping. Much has already been done here. In this connection we may mention the institution of unemployment insurance which removes a border line question of the kind from the dispute as to jurisdiction and in so doing relieves both the Reich and the States of expense. Further work must be done in this direction, and in the sense that the Reich should in reality retain only such functions as devolve on the whole of the German nation and cannot be carried out by the individual State, or not in a practical manner. The third essential is the simplification of the administration of the States and Communes themselves. The States and Communes are the result of historical development; they are part of an economic system which they cannot well fail and which in the past they have not failed. This development entails the compulsion to extreme economy in the public administration in the interests of the nation as a whole, on which heavy burdens are placed. It is unnecessary to point out that here, as in every case of administrative simplification, resistance has to be overcome. On the other hand, the States have on their own initiative given evidence of valuable endeavours to continue the work. Several States have already called on the Economy Commissioner of the Reich, in order to discuss in conjunction with him means for the reorganisation of their administration. Other States are endeavouring independently to reach the same end. But that we are at the beginning and not the end of a mighty task will be denied by none who follow



attentively the efforts now being made both in private and in State economy. In this matter the Reich will always play its part. It will be at the disposal of the States with advice and, where this is desired, also with practical assistance. It will take steps to ensure that, so far as is in any way possible, the means for overcoming deficiencies in the administration are clearly shown. The Reich can never hold the view that things as they are are unchangeable; on the contrary it considers its duty to be, everywhere to collaborate so as to simplify and clear up the general system, with the object of reducing the cost of administration and in consequence the volume of public charges.

Connected with this is the much discussed question of the control of the revenues and expenditures of the Federal States and Communes. Here also far-reaching claims are made, which however are in many cases based on premises not entirely reflecting the real state of affairs.

We shall deal first with revenues. The Income Tax and the Corporation Income Tax, like the Tax on Real and Personal Property, were reserved for the Federal States. The Reich has taken over these taxes. It gives 75 per cent of the Income and Corporation Income taxes back to the States and reserves for itself 25 per cent of the proceeds together with the whole of the Tax on Real and Personal Property. The delimitation here is perfectly clear. The claim is now put forward that the transfers to the States should be restricted to a definite sum, which is equivalent to excluding the States from participation in the upward movement of enterprise. It is true that such a course might be discussed in a State which was economically stable. It can however hardly hold good in a State where the underlying aim of all work is always the return to normal conditions. Any decision is

utterly impossible until we are clear as to what are the normal requirements for the regular working of the Reich, the States and the Communes. On this point the Dawes Plan contains a noteworthy reference. According to the Plan the resources normally to be assigned to the States and Communes should not exceed their legitimate needs. Only when further assistance has to be given by the Treasury of the Reich should such assistance be subordinated to continually increasing central supervision by the Reich of local expenditure. These recommendations of the Experts' Plan reveal the knowledge of the Experts on the matters here under consideration, since they distinguish between the general financing of the States and Communes and the granting of extraordinary assistance.

The general financing of the States and Communes must be confined to their "legitimate needs". For these, no control of expenditure is provided. It is the function of the financial settlement to determine the amount of these legitimate needs. The statistics which have now to be furnished are intended to prepare the way for the regulation of the question by the definitive financial settlement. In the present settlement we have an interim solution introduced with the object of giving peace for work in the Reich and States and time to establish the bases for a definitive settlement. Generally speaking it is thought abroad that the transfers to the States and Communes are too high; the States and Communes think them too low; the Reich may under these circumstances well feel that it has found a middle course. It would be highly dangerous, before the question of their requirements is fully settled, arbitrarily to apply reductions to the revenues of the States, since under the circumstances these might mean that States which have vitality in themselves were unable to carry out their duties and were forced to bring the machinery of Government to a standstill. It is unnecessary to point out



that the Reich would then be burdened not only with heavy political responsibility, but also with costs the amount of which cannot be foreseen. It remains the duty of the Reich in the meantime to ensure that its own finances and those of the States and Communes are as lucid as possible. This object is served by the tax unification Law, which endeavours to establish uniform bases for the main taxes left to the States, to equalise their rates, and to institute a joint administration by the Reich and the States for all important taxes. Where special assistance is concerned, the Reich has ensured control which is as far-reaching as possible in cases where it has not retained the function of payment in its own hands. In this connection, I may refer to the strengthening of the measures of control which the Reich demanded and obtained when it took over the charges for unemployment relief pending the application of the insurance system. Now a further step is demanded of us - control over the Communes. I think that no one with practical experience can doubt that, without exaggerated administrative machinery, no effective control by the Reich of revenues and expenditures is possible; the machinery in question would have to control 60 000 Communes and would tower above the States, the result being to increase friction and so most acutely to disturb the work of the administration. If action which is useless or even dangerous for the State is to be avoided, it is necessary to forego direct and general control of the individual Communes by the Reich. It is here a question of keeping the conception of autonomy, which is so beneficial for municipal administration, in accord with the general financial requirements of the Reich and with the requirements of national enterprise. For this task the States, which are entrusted with the control of the Communes, are specially indicated. The Reich should only intervene in order to avert dangers which cannot be

otherwise overcome. For I certainly consider it necessary that the Reich as the supreme authority should then interest itself in these matters. Even to-day however the influence of the Reich is not lacking in either branch of revenue - the taxation branch or that dealing with loans. The right of protest under the financial settlement Law (Finanzausgleichsgesetz) protects the Reich from communal taxes which might prejudice its own revenues. The Advisory Office on foreign loans, which is set up in agreement with the States, watches over the loan policy of the States and Communes from the point of view of the currency, the national economy and the finances of the whole of Germany. I will here merely record the fact that we have recently introduced stricter regulations with which, I feel sure, the States will declare their agreement, owing to the general interests clearly involved. The States and Communes, in the difficult matter of loans, have always subordinated their wishes to the general good of the Reich. But this loan policy also has recently been subjected to special criticism. It will be necessary to say one word in explanation of the standpoint of the Government of the Reich. We take the view that the contracting of loans by the States and Communes for administrative purposes cannot be permitted at the present time, owing to the shortage of money on the home market and the extreme caution indicated on the foreign market. The duties of the Communes in Germany however are not exclusively those of administration. In contrast to wealthier countries, the development of the communal system in Germany and the shortage of private capital for investment has made it widely necessary for the Communes to satisfy requirements of private enterprise which in a richer country could have been satisfied from private sources. The provision for the population of gas, water, electric light and the public means of transport in Germany has in practice devolved to a great extent on the Communes. It is



unnecessary to explain that loans for these services can be productive in the widest sense of the term, in so far as they alone can enable private enterprise in the Communes to undertake new and fruitful work. On the other hand, it goes without saying that in these productive expenditures and the applications for loans which they entail the Communes have to pay due consideration to the general situation in Germany. On October 7 the Government of the Reich declared that in view of the general position it was necessary to avoid all expenditure which was not urgent or economic in nature, irrespective of whether it was covered from external loans or inland sources of revenue. In so far as the Communes are engaged in the above-mentioned branches of private enterprise, no reasonable loan policy can admit a rejection in principle of their applications to borrow. In each individual case however it will be necessary very strictly to enquire whether the general economic scheme submitted by a Commune guarantees the essential productivity of the expenditure, and whether it is really impossible for the expenditure to be met from current resources, even if this should mean the withdrawal of other less urgent outlay. For in general earnest endeavours must be made to restrict the public expenditures. In so doing we do not follow external compulsion, but recognise internal necessity; for the total debt of Germany really gives cause for very great reserve.

I have attempted to give you in rather more detail a picture of the financial situation. May I now summarise the essential points; in the four years of stabilisation the ordinary expenditures have risen by approximately  $1\frac{1}{2}$  milliards in all. The increase is, as I have explained, inevitable and has its origin in a prudent financial policy. Most of the expenditure has gone to reconstruct possessions destroyed by the war and the inflation. In regard to the extraordinary expenditures, which have been considerably

augmented during the last few years, I hope as early as 1928 to reduce them to proportions corresponding to a normal administration. Of the expenditures for 1927, war charges total  $3\frac{1}{2}$  milliards, or more than half the total expenditure of the Reich. The heavy sacrifices demanded of tax-payers are evident and are mainly to be attributed to the loss of the war. In the past years, it was impossible to carry out the measures concerning the salaries of officials and owners of liquidated property which public opinion in Germany has for so long united in urging upon the Government. The enforcement of these measures can no longer be postponed, in the interests of reconstruction in Germany and consequently of the further execution of the Experts' Plan. They form the conclusion to the work of construction of the last few years. They are not the first stage in an unsound financial policy, but the closing stage in the work of reconstruction to be carried out in the transition years. The Government of the Reich supports the utmost economy and the very strict examination of all expenditure, since only in this way will it be in a position to promote economic advancement in Germany and so to render possible the fulfilment of the obligations assumed.

The Government of the Reich is fulfilling the obligations assumed to their full extent. It has made the annual payments and is now - as ever - endeavouring to the best of its ability to assist the work of the Transfer Committee within the limits of a reasonable financial and economic policy. Germany has on many occasions given an assurance of her sincere desire to fulfil the duties undertaken by her. She has subordinated her whole financial and economic policy to this end. The annual budgetary contributions are now secured by the controlled revenues to more than 100 per cent of the actual claims. Germany's financial policy has stood and is still standing under the



sign of growing reparation charges. The main part of the expenditures of the last few years has gone to promote the reconstruction of the national economy - the economy which has to bear the burdens of the Dawes Plan. It has further served for the re-introduction of a proper standard of living which even the Dawes Plan allows to the German nation. The general policy of the Reich has been conducted in the knowledge that by every means in its power, even if sacrifices are involved, it is essential loyally to fulfil the London Agreement, which was described by the Experts who planned it as an attempt to settle the reparation question on practical lines and with reference to economic considerations, by which, as we hope, its execution will always be governed. I shall here close this section, but am however prepared to give further explanations in connection with events of the last few days. I must however ask that this part of my speech be treated as confidential.

Referred to in letter of 11/23/27

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T.D. No. 269 G

SPEECH  
BY THE PRESIDENT OF THE REICHSBANK  
DR. HJALMAR SCHACHT

AT BOCHUM  
ON FRIDAY NOVEMBER 18, 1927.

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OUR OWN CURRENCY OR A BORROWED CURRENCY ?

A stable currency is not permanently possible without economic equilibrium. When people speak of danger to the currency, many think only of depreciation of the bank note. But the term "currency" implies something more than mere maintenance of the gold value of a bank note issue: it implies the necessity for supplying the national economy with an adequate amount of stable media of payment. A bank note with a full gold or gold value cover may be able to maintain itself even in countries whose national economy is disordered: a currency, which is covered in part by creditor claims such as bills, requires two solid foundations, a balance of external payments in equilibrium and a balanced national budget. In Germany the capital losses of the war and the inflation periods and the withdrawal of income for reparation payments have made heavy inroads alike on budgetary equilibrium and on the balance of payments.

So long as we were in the dark as to what we should have to pay in reparations, the equilibrium of the balance of payments and of the budget were permanently menaced from without. One of these menaces, the threat to the budget, has been removed by the Dawes Plan. We are no longer ignorant of what burden we have to support, so far as payment in our own currency is concerned: we know that from next year onwards Germany has to carry an annual reparation



charge of  $2\frac{1}{2}$  milliards of reichsmarks. But the Dawes Plan was not able to remove the menace to our balance of payments. The inherent aim of the Plan was to have the  $2\frac{1}{2}$  milliards paid annually in foreign currency to the full amount, so far as possible, in which connection it is indifferent to the German national economy whether the payments are made in kind or in cash. As however the authors of the Dawes Plan recognized the possible or probable impracticability of annual payments to foreign countries on so large a scale, they made the actual effecting of the payments dependent on the personal views of the so-called Transfer Committee. All efforts to establish equilibrium of our balance of payments are therefore subject throughout to permanent uncertainty. Until a tolerable total figure is fixed for the payments which Germany has to make to foreign countries, there can be no effective results of the efforts to attain equilibrium of the balance of payments.

In spite of the severe injury to the foundations of our national production as a result of the losses incurred, we have succeeded since the date of the stabilization of the mark in maintaining the budget and the balance of payments in equilibrium and the international, no less than the internal, purchasing power of the German currency on a footing of stability. Measured by the international exchanges, the reichsmark has remained stable between the two gold points; and even when judged by the criterion of internal price movements the purchasing power of the mark has not been subject to any considerable variations. The only peculiar feature of our position is the fact that this equilibrium is maintained, not merely in virtue of our own surplus production, but as a result of credits received from foreign countries. That in itself is not a regrettable circumstance. When a country has been so denuded of mobile capital as Germany has been owing to the war and the inflation, it is altogether natural and justifiable that it should do as private business concerns do and

have recourse to credits for a transition period. But it is essential to keep in view the necessity of not allowing such recourse to credits permanently to postpone the equilibrium of the balance of payments: it can only be allowed temporarily to postpone the final balance, and such postponement cannot be indefinitely continued. No country can conduct its business permanently on credit. How long the ultimate settlement can be postponed depends in the first instance on the readiness of those who supply the credit to provide the funds, and the readiness of those who supply the credit depends as much as anything on whether the interest and amortisation payments on the debt can be made available by the borrowing country in such a form as to be transferable to the lender in foreign currency. Here again it is conceivable that for a certain period the interest and amortisation service of a debt can be met by fresh borrowing: but the time must eventually come when the borrower has to finance the service of the debt out of his own resources, which means that foreign borrowing is only justifiable insofar as national production is thereby stimulated and enabled to lay by new capital in the form of savings.

The point therefore is, to what purposes the foreign credits are devoted. There were countries even before the war which borrowed from abroad on a large scale. The most illuminating example of such borrowing is afforded by the United States of America and the other countries of the New World in the nineteenth century. In the case of all these countries the object of the borrowing was the opening up of new colonial territory. All these countries developed their agricultural and mineral potentialities by the import of means of production which were procured with borrowed foreign money. As they developed their agricultural production and their production of raw materials, they gradually paid back the loans which they had had from Europe. It is only necessary to analyse the history of the foreign trade of the United States or



the Argentine to find confirmation in figures of the fact that in the first decades of their modern economic history these countries all showed an adverse balance of trade because they imported more means of production than they were able to pay for at the outset, while at a later period - in the case of the United States from about the eighties of the last century onwards, and in the case of the Argentine from the end of the last century onwards - they began to pay off their foreign credits out of surpluses in their respective trade balances, consisting principally of agricultural products and raw materials. In new colonial countries this form of capital investment is a natural and normal process.

The circumstances are very different in the highly industrialised countries of Europe today and especially in Germany. Germany is not a colonial territory. What colonial countries need for their development, that is to say means of production, Germany possesses on the most lavish scale and, where she does not possess them, is in a position to manufacture them herself. The credits which Germany takes up cannot be paid for with foodstuffs and industrial raw materials, which are readily realisable objects of trade in every country, but only with finished products; and for the marketing of finished products there is the severest international competition throughout the world. When therefore the advocates of extensive foreign borrowing in Germany maintain, as they continually do, that the foreign credits are necessary for the reconstruction of the German national economy, that is only true to a very limited extent. The German trade figures show that, apart from certain special cases, we do not import means of production but foodstuffs, raw materials and finished articles, especially the first two.

Undoubtedly Germany was denuded after the war on a very extensive scale of stocks of raw materials and, if she was to employ her industry once more, it was

essential that she should replenish the exhausted stocks, which for the most part could only be done by means of credit. Insofar as this process of replenishment has taken place on the scale required for the immediate vital needs of the German population, no objections can be made against it. But where over and above such imports raw materials have been imported on credit, this can only be regarded as admissible to the extent to which finished products manufactured from these raw materials find their way on to the world market and so help to pay off the credits, since there is no possibility for us of paying them off by the export of raw materials as in the case of colonies.

It becomes therefore necessary to observe moderation in the volume of our foreign indebtedness. From the day on which the Dawes Plan was accepted down to November 12, 1927 inclusive,  $5\frac{1}{2}$  milliards of reichsmarks of long-term foreign loans have been taken up according to the statistics of the Reichsbank. We may estimate, on the basis of material collected by the Reichsbank from the banks, that the total short-term indebtedness of the country is not very far behind the amount of the long-term indebtedness, so that the total of the country's foreign debt, short and long, may be put at something like RM 10 milliards. As against this indebtedness there must of course be put our own creditor claims on foreign countries, which are not so easy to estimate but no doubt amount in the aggregate to some milliards. Whether our claims on foreign countries are as short and as liquid as our short-term debts to those countries is open to question. But it must of course be remembered that Germany cannot export commodities, as her creditors desire, without giving a certain amount of credit to foreign countries.

So far as our present currency position is concerned, the essential consideration is that an annual payment of approximately RM  $\frac{3}{4}$  of a milliard is required for the interest and amortisation of our foreign debts. When in



addition we remember that in the current reparation year about RM 1 milliard in cash will have to be transferred, and further that for some time to come we shall have to reckon with the payment for the surplus of our imports over our exports of merchandise (which is the first nine months of this year amounted to approximately RM 3 milliards), it will be seen that an annual liability to foreign countries of several milliards already exists. It is true that Germany acquires foreign exchange from exports and from transportation and other services carried out for foreign countries, and to some small extent perhaps from capital invested once more abroad. At the present time however the aggregate of all these items is insignificant, and the adverse balance of payments has so far been covered mainly out of loans. One may therefore ask with justification whether we are to continue borrowing from foreign countries a few more milliards every year. I imagine anyone can reckon on the fingers of one hand when this system must end.

One favourite argument is that we were obliged to borrow abroad in order to reconstruct private enterprise and to supply our money market with liquid working capital. By this borrowing, it is said, we rationalize our industrial machinery and stimulate business inside Germany while at the same time cheapening production, as a result of which we shall later be enabled to pay off the debts by means of increased exports. From the same quarter comes the contention that we ought to import foreign money in order to lower interest rates in Germany and so reduce the shortage of liquid working funds. Underlying this line of thought is the extremely uninformed view that the existence of dollars in Germany in itself represents a form of capital. Very few reflect that in the last resource dollars can only be spent in America. Dollars imported into Germany can only be used for the payment of debts which we have abroad, or for capital investment abroad, or in payment of foreign merchandise imported into

Germany. We may here leave the first two alternatives out of account, as they have little bearing on the German recovery. In regard to the importation of foreign commodities - of which every borrowed dollar acts as a stimulus - we have already seen that the articles imported are only in rare cases means of production for direct rationalization. Generally they are raw materials and foodstuffs, of which only a small part is worked up here and sent out of the country again; the greater part of them involve increased domestic consumption - on credit. How far the increased internal turnover increases the export capacity of the industries affected is a question on which there is so far no evidence either of theory or of practice.

There is one other use to which dollars can be put in Germany; they may be presented to the Reichsbank with the request for the issue of banknotes in exchange, and these notes are thereupon available for use within the country. Up to the present the Reichsbank has done this on a very large scale. When it is remembered that at the time of the reconstruction of the German currency the Reichsbank began with a gold and foreign exchange holding of practically nothing, and that only a fraction of the foreign exchange subsequently received by the Reichsbank was the property of Germans, it is clear that a considerable part of the gold and foreign exchange holdings of more than RM 2 milliards, which are now in the possession of the Reichsbank, has its origin in the foreign money which has reached Germany in the form of loans. The question now arises as to how far the Reichsbank, when it gives German banknotes in exchange for dollars, is making credit and capital available in Germany. Here again there are theorists who hold that this is possible to an unlimited extent and that the Reichsbank, for example, can issue banknotes for RM 20 milliards in exchange for 5 milliard dollars. It is only necessary to put the proposition in this extreme form in order ~~at~~ once to show the impossibility of



putting the theory into practical application. A currency circulation in Germany of 20 milliards would be nothing but an inflation and would be bound to find expression in an excessive rise in prices and wages. A gold inflation of this kind took place in the United States of America immediately after the end of the war, when the note circulation of the Federal Reserve system reached in December 1920 the sum of over 3.3 milliard dollars. The banks of issue set themselves to counter the disastrous consequences of this gold inflation by a systematic restriction of the note circulation, which in the course of 1921 was contracted to 2.4 milliards, with the result that prices and the conditions of production again became normal.

The currency circulation of a country must stand in some definite proportion to the extent of the country's economic activity. It can no doubt be larger when trade is brisk than it can in quieter periods; but the aim which has always to be held in view is that the purchasing power of money should observe as stable a tendency as possible in its relation to commodities and wages. The limit for the volume of circulation in Germany is not fixed by any mathematical law. It is a thing which has to be sensed from the various phenomena of the country's economic life. Attempts are frequently made to compare our present currency circulation with the pre-war figures. The total circulation before the war was estimated at approximately 6 milliard marks. This total included about  $2\frac{3}{4}$  milliards of gold coins, a considerable proportion of which did not circulate at all, but were hoarded in stockings and chests. Generally speaking, the rapidity with which money circulated before the war was certainly less than it is today. On the other hand it is argued that the level of prices today is about 50 per cent higher than before the war, so that a higher volume of circulation is required in order to enable the country to finance its current payments. Here again it is frequently forgotten that

payment transactions, in which no actual currency changes hands, have increased to an extraordinary extent as compared with the pre-war period; that is to say, a very much larger proportion than formerly of the business of the country is transacted, not in cash, but by credit and debit entries in the books of the banks. The Giro and clearing business of the Reichsbank is about 50 per cent more extensive than it was before the war. Postal cheque business, which deals in the main with precisely those small payments which previously were made in cash, has approximately trebled in comparison with the pre-war period. In addition there is the communal clearing business of the Girozentralen, which represents an entirely new feature. Considering all things therefore, the Reichsbank takes the view that a currency circulation of approximately RM 6 milliards or rather more, such as we have today, is adequate except in abnormal periods, and should not be considerably enlarged under present circumstances if we are to avoid an upward movement of prices and wages, in other words if we are to avoid inflation.

The present note circulation of the Reichsbank is covered in full, partly by the gold and foreign exchange in the Reichsbank's possession, and partly by its holdings of commercial bills. Unless therefore the Bank is prepared to increase its note circulation, it cannot take new foreign money and give German currency in exchange, except in the event of its holding of bills being simultaneously reduced, that is to say, in the event of reduced recourse by the public (i.e. by its bill clients) to its credit facilities. The exchange of German for foreign money by the Reichsbank means merely the substitution of foreign credit for Reichsbank credit: no new credit facilities are created for the German public. Should foreign capital notwithstanding continue to come in to the Reichsbank for exchange against German currency, the only course open to the Bank, if it is to regain its freedom of action, is either to raise the



discount rate or alternatively to restrict bill credits. Even the lay mind will perceive the absurdity of such a position.

From what has been said, it will be apparent that the possibilities of bringing productive capital into Germany by means of foreign borrowing are extremely limited. The process is complicated by the highly industrialized character of German enterprise, to which there is no parallel in colonial countries. The additional capital which Germany undoubtedly requires must therefore be obtained by some other means than foreign borrowing, and this other means can only be the formation of domestic capital, which is conditional on increased production and increased saving.

Increased production can find expression either in the form of a rise in exports or in a fall in imports. Both affect our balance of payments equally, but they differ in respect of the conditions necessary for their realisation. A rise in exports is dependent on the capacity and readiness of foreign markets to absorb German goods (and so on the economic and commercial policy of foreign countries), whereas a fall in imports depends more on the steady development (which we can ourselves control) of economic conditions in Germany. In both directions the Reichsbank has done what it could to assist. It has adopted a series of measures to promote industrial exports, while by a further series of measures it has helped to increase agricultural production with a view to reducing import requirements. It is obvious that a country which aims at exporting to other countries cannot itself indulge in protection. German commercial policy is therefore undoubtedly following the right path when it aims at the free market: but freedom of markets is only attainable if we have ourselves a market as free as we can possibly make it. It would be a mistake however to make too much of this point alone, and to neglect the task of developing alike the quality and the quantity of agricultural production: quality is as important as quantity in this connection.

Increased saving must aim at replacing as soon as possible from our own resources part of the capital which we have lost. The extent of capital formation in Germany as against foreign borrowing is clear from the fact that, in the same period in which we raised RM 5 $\frac{1}{2}$  milliards in long-term foreign loans, we placed nearly double this amount in bonds and shares on the internal German market. The effect of saving is both physically and morally much greater than that of borrowing. But saving means consuming less, and a call to reduced consumption, especially when it is addressed to individuals, enhances no one's popularity. There are however more opportunities than one for saving, and the call to economise does not mean that individuals need deprive themselves of the benefits of civilization. But, although such renunciation is not to be expected of the individual, the public authorities should insist the more on economy, because they have a special responsibility to the public and in virtue of their position inspire a general tendency and set a general example. Quite apart from the question of reparation payments, from the point of view of the reconstruction of our domestic capital alone, we are bound to require of our public authorities great self-denial in the matter of expenditure. It cannot be denied that the public authorities have to a great extent failed to deny themselves as they should have done. The Reichsbank has repeatedly expressed its views in the course of the struggle for the restriction of public expenditure, because it was obliged to do so, and will in future be obliged to do so, for the reason that the failure to exercise a wise reserve in expenditure is responsible for the heavy foreign borrowing of the public authorities. If the public expenditure were dependent only on domestic taxation or on the home money market, the interest of the Reichsbank from the point of view of currency policy would perhaps not be so direct. An indirect interest would indeed always be present, since under § 1 of the Bank Law the



Reichsbank is obliged to provide for the utilization of available capital. Its interest in the whole question is however considerably strengthened when the public authorities incur debts to foreign countries and so artificially sap the currency foundations of the Reichsbank.

An absolute essential for the maintenance of a gold currency is the proper functioning of a free foreign exchange market, which means that the Reichsbank must always be prepared to hand out a dollar for (in round figures) RM 4.20. If therefore payment liabilities to foreign countries exist, which are not offset by an adequate supply of dollars on the open market from other sources, the Reichsbank is forced to part with dollars from its own reserves. If it failed to do so, a premium over and above the price of RM 4.20 would immediately be constituted for the dollar, which would be equivalent to the depreciation of the Reichsmark on the international market. In the event of an increased demand for foreign exchange, the Reichsbank is not the last, but the first, source of supply, since when a shortage of foreign exchange arises holders of such exchange naturally keep back their reserves, unless circumstances force them to act otherwise. Under the Bank Law the Reichsbank is obliged always to keep a definite amount (40 per cent) in gold and foreign exchange as cover for its note circulation. If it is required to produce so much foreign exchange that it cannot maintain the 40 per cent gold and foreign exchange cover, it is obliged in consequence to reduce its note circulation. A few figures will illustrate this point. When the Reichsbank possesses gold and foreign exchange for RM 2 milliards, it can issue in return notes for RM 5 milliards. If from its two milliards one milliard in foreign exchange is withdrawn, it must reduce its note circulation to RM  $2\frac{1}{2}$  milliards. In other words, in return for the surrender of RM 1 milliard's worth of dollars it must withdraw  $2\frac{1}{2}$  milliards of reichsmarks from circulation, and must therefore correspondingly restrict its bill holding and in consequence its credit

facilities also. Whether it does this by raising the discount rate or by restricting credits is in the first instance a matter of indifference. Such a withdrawal of credit facilities means severe pressure on private enterprise and must bring about the liquidation of stocks of commodities, securities, foreign exchange and other capital investments. The higher the annual liability of Germany to foreign countries for interest and amortisation of loans, for reparation payments in cash and for the financing of adverse trade balances, the more threatening does the situation become for the Reichsbank and in consequence for the currency supply of the nation. Just because the Reichsbank realises its responsibility for the maintenance of an adequate circulation of stable media of payment, it cannot allow anyone who pleases to contribute to the increase in our foreign commitments. The question therefore arises, at what point does the Reichsbank policy of restricting foreign borrowing begin to intervene ?

Public enterprise in Germany pleads the fact that like private enterprise it is directly responsible for the economic exploitation especially of light and power, and therefore it claims the same freedom in the issue of foreign loans as has hitherto been granted to private enterprise. This attitude originates in the same mentality which conceives of the State as a third person existing apart from the individual citizens, whereas actually the State is nothing more than the collective body of citizens. This false conception of the State is a remnant of pre-republican times when the individual citizen regarded himself as the enemy of authority. Today, when public enterprise and the public authorities are identified with the citizens as a whole, it is quite obvious that public enterprise must take the lead in giving practical effect to the principle of the maintenance of the welfare of the entire State. I am not going into the question whether the undertakings run by the



authorities are worked more economically and more advantageously to society than the undertakings of private enterprise, although it would be a very good thing to test the comparative efficiency and profit-earning capacity of public and private enterprise, and also the working of public monopolies which frequently are nothing more than a form of tariff policy concealing taxation. Instead I would only point out that, so far as foreign borrowing is concerned, public enterprise cannot be considered as a problem by itself because it represents only one side of the public financial administration, and therefore the financial position of public enterprises taking up foreign loans must be examined in relation to the public finances as a whole. The indebtedness of a public undertaking differs fundamentally from the indebtedness of a private undertaking in the fact that the private undertaking risks its own head whereas the administrators of a public undertaking risk the heads of the tax-payers. The private undertaking will therefore minutely examine the question of profits in connection with any loan it contracts, whereas a public undertaking will be governed by quite different considerations, more especially by considerations of a general administrative nature. The warning to public authorities to restrict their foreign borrowing is therefore particularly justified.

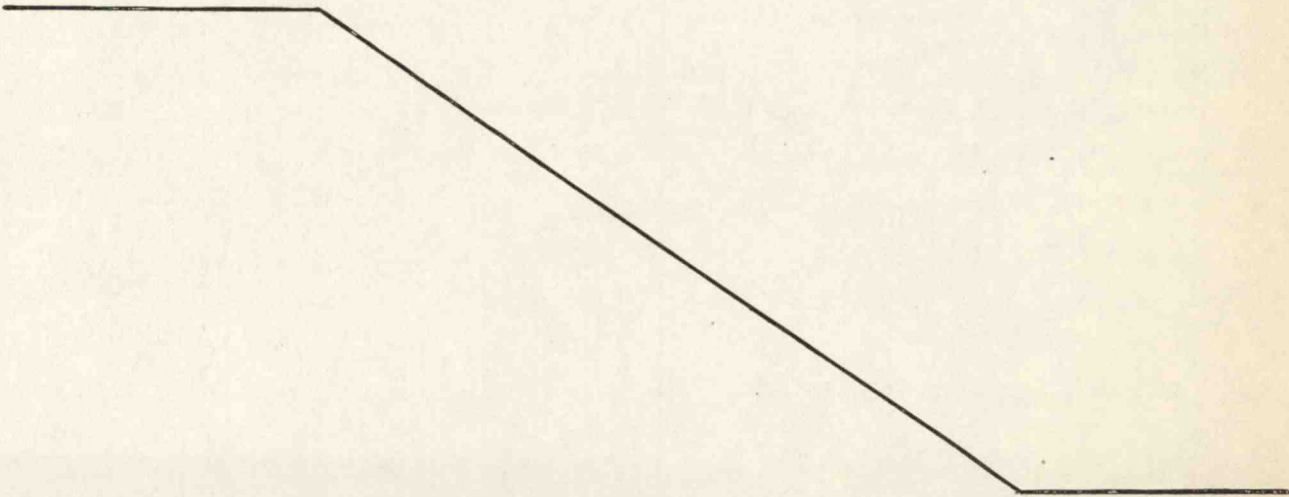
Of the RM  $5\frac{1}{2}$  milliards (in round figures) of long-term foreign loans hitherto contracted, public enterprise is responsible for  $2\frac{1}{2}$  milliards, private enterprise for  $2\frac{1}{2}$  milliards, while  $\frac{1}{2}$  milliard represents semi-public loans such as those of the Rentenbank-Kreditanstalt etc., all these being round figures. Of the RM  $2\frac{1}{2}$  milliards of foreign loans contracted by public enterprise the Reich is responsible for quite 900 millions, a bare RM 300 millions represents guaranteed State or communal loans, while the balance of RM 1,300 millions (in round figures) is about equally divided between the

States on the one hand and the communes and associations of communes on the other. It is not of course the business of the Reichsbank to meddle with public financial policy. But if the currency is endangered by a misguided public financial policy, it is the duty of the Reichsbank to draw attention to the fact. For this reason the Reichsbank has repeatedly warned the public authorities to restrict expenditure, and that not only recently but ever since the stabilization. In February 1924 in Königsberg I emphasized the necessity of reducing taxation in the interests of the national economy. In October 1924 I pointed out in the Central Committee of the Reichstag that the social activities of the municipalities ought not to be extended beyond the limits of what the national savings allow, and I urged that co-ordinative measures should be adopted with a view to effective control of the indebtedness of the public bodies as a whole and in particular with regard to foreign borrowing. On my return from my first trip to America at the opening ceremony of the new Reichsbank building in Stuttgart in December 1925, I insisted that communal schemes and many State schemes must be cut down in the interest of the country as a whole. I mention these earlier instances only, since more recent efforts on the part of the Reichsbank will be within your recollection.

In opposition to these efforts the communes in particular have repeatedly contended that their foreign loans were only contracted for genuinely essential economic, so-called productive purposes, and that the expenditure on apparent luxuries - including Stadiums! - comprised only an infinitesimal part of the whole. But I maintain that, if the municipalities had been content to forego expenditure on luxuries or non-essential expenditure, it would very probably have proved unnecessary for them to



contract a single loan abroad. The Reichsbank of course is only in possession of incomplete data on communal finance, but the data available are sufficient to show that the sums expended by the communes on the erection of Stadiums, swimming baths, open air spaces, ornamental grounds, the purchase of sites and estates, exhibition buildings, festival halls, hotels, office buildings, planetariums, aerodromes, theatres and museums, the granting of credit, the acquisition of holdings in private enterprises and so on and so on add up to a total which is not far short of the total amount of the foreign loans which they have contracted. The prevailing inaccurate impression of the actual extent of this expenditure is due to the fact that every individual municipal administration sees only the expenditure incurred by itself, whereas the Reichsbank has to survey economic and currency problems as a whole. I would therefore like to emphasize once again that it is essential to arrive at a clear understanding with regard to our communal finance before we contract any more communal loans abroad. To say so much is not in any way to impinge upon the principles of local self-government, still less federalism. No one in Germany will contend that local self-government or federalism should stand in the way of healthy financial and currency policy in the Reich.



The attitude of the Reichsbank to foreign indebtedness on the part of public enterprises as opposed to the indebtedness of private enterprise is quite comprehensible for the reason that public enterprises only produce foreign exchange on a very small (and that a diminishing) scale; the production of foreign exchange is left to private enterprise. In this case also private enterprise is risking its own existence, whereas public enterprise is risking the life of the business population of the country. This will be clear if we ask ourselves how the foreign exchange needed in Germany for the interest and amortisation of our debts, for cash transfers and the financing of adverse trade balances is to be obtained if and when new foreign loans, out of which the greater part of these liabilities have hitherto been financed, should one day cease to flow into the country. If there should then not be enough foreign exchange to meet our liabilities, and the Reichsbank should have to part with its foreign exchange holdings and to effect a correspondingly severe reduction of the note circulation, the result would be a crisis and a general national liquidation. The foreign exchange would have to be procured at all costs; our goods would have to be sold abroad at any price, and employers and employees would have to make the greatest sacrifices. The policy of the Reichsbank must be directed towards preventing such crises as far as possible, and it is therefore the duty of the Bank to utter a timely warning against excessive foreign borrowing. The Reichsbank cannot adopt the light-hearted attitude of those who say : "Go on borrowing as long as you can and let the future decide if, when the day of settlement arrives, we shall be able to produce the necessary foreign exchange or if we must declare ourselves unable to pay." No one in Germany is prepared seriously to contend that, if we continue our present policy of foreign borrowing, we shall be able to produce the necessary foreign exchange, if indeed we can produce it at all, without incurring



a serious crisis; and no one is prepared seriously to contemplate even a temporary inability on the part of Germany to meet her international obligations. That is why all reflection on the question leads to the conclusion that excessive foreign indebtedness must be avoided by economy and sound administration at home.

The Dawes Plan left the definite fixing of our reparation liabilities still unsettled. Sensible people throughout the world are already agreed that this state of affairs cannot continue ad infinitum. It would be a great mistake to raise this question for discussion at the present time before the expiration of the four years of probation. I very much hope that the discussion which has recently arisen in the international press as to the respective priority of transfers for private and public loans will not make it difficult, or even impossible, to execute the Plan loyally during the four probationary years. To me the entire discussion on the priority of transfers seems quite beside the point. Every one will acknowledge - and the Dawes Plan itself with wise foresight recognizes - that foreign loans were and still are absolutely essential to the recovery of Germany, at any rate during the period of transition. Industrial prosperity and the highest possible agricultural production are essential conditions of the execution of the Plan. The influx of a certain number of foreign loans (not excluding a certain number of loans by public enterprises) is inevitable for this purpose; and if Germany has hitherto shown and will continue to show complete loyalty in executing the Dawes Plan, we can and must expect a similar loyalty on the part of our political creditors. Unfortunately during the war and in the so-called Peace Treaty we have seen the most unjust and foolish attacks on private property. These attacks on private property were undoubtedly one of the reasons why the bolshevist wave temporarily swept over the country. Indeed I do not hesitate to assert that these attacks

on private property gave bolshevism the pretext of a moral excuse. Since the end of the struggle in the Ruhr, since Geneva and Locarno, however, we have all returned to common sense, and under no circumstances can I conceive of a repetition of the political machinations by which the private owner of a German loan coupon in the United States or elsewhere - no matter whether the coupon was issued by a private or a public body - was prevented from collecting the interest by a prohibition to Germany to make the payment. The Power, which attempted to repeat such a prohibition, would completely annihilate its own credit at a single stroke. So long therefore as a highly civilised nation of 60 millions is not artificially prevented by external political intervention from the peaceful continuance of its work, so long as private enterprise in Germany is guided by capable, honest business men of high standing, so long as German public finance is administered economically on sound principles, no one who has trusted Germany financially will be disappointed. There is not the slightest indication that international politicians, German business men or the German Government could now lack the good will and the ability to act on sound common-sense principles.

The practical impossibility of graduating the priority of the different categories of German loans in the matter of transfer, places a correspondingly greater responsibility upon us in the matter of our foreign indebtedness. But even the pace of urgent foreign borrowing must be voluntarily restricted if the German money market is not to pass entirely out of the control of the bank of issue and to be at the mercy of the arbitrary desires of borrowers. The excessive influx of foreign loans in 1926, at a time when the market was not in any inordinate need of funds, led to a cheapening of short-term money on the home market, with the result that the Reichsbank lost touch more and more with the money market and was finally compelled in spite of the obvious



objections to reduce the discount rate in January 1927. Although a discount rate of 5 per cent was calculated to reduce the influx of foreign money, and although the Reichsbank showed itself willing to place the abundant supply of foreign exchange accumulated in 1926 at the disposal of commerce in return for bills, the banks nevertheless took up a large amount of short-term foreign money and used it to expand their credit, thus compelling the Reichsbank once again to raise its discount rate. It will be seen that the discount policy of the Reichsbank does not depend primarily, as in pre-war days, on economic conditions, but is to a very large extent subject to the (arbitrarily manipulated) influx of foreign credits. This danger to the money and currency policy of the bank of issue can only be dealt with if all those who hold a leading position in Germany, public or private, will realise their responsibility in the matter. We who have so long been accustomed to being led from above are still suffering from the lack of the spirit of voluntary co-operation and esprit de corps. We appeal, and rightly, to the ideal of freedom and protest against tutelage; but there is a corresponding obligation to keep alive our sense of responsibility to the community. It will not do to blame the authorities for every mistake, while we claim the right to irresponsible and selfish action for ourselves.

In our young republic this lack of a sense of responsibility is still conspicuous in more quarters than one. Private enterprise showed a lack of this sense of responsibility when it incurred short-term debts abroad at the expense of the German currency at a time when the Government and the Reichsbank were endeavouring to dam the influx of foreign loans. It was lack of responsibility, at a time when owing to the extreme scarcity of capital 7 per cent mortgage bonds for lack of investors were barely at par, to create a boom in stock exchange shares and to encourage the public - which had no spare capital

for such purposes - to run up debts for the purchase of shares at rates which did not even offer the prospect of a 3 per cent yield. It was lack of responsibility when a municipal administration erected palaces at a cost of many millions and purchased private estates, while it declared in the same breath that it could not build dwelling houses because the Reichsbank opposed a foreign loan intended for the purpose. It was lack of responsibility when the Treasury accumulated huge funds by exaggerated taxation, and then employed them in credit transactions or in the purchase of private undertakings. It was lack of responsibility for a State bank to claim a share of public funds with the assertion that these funds were to be made available to local enterprise within the State concerned, and then to leave these funds for months at a time on the Berlin Bourse.

All these examples, many more of which could be given, are due to out-of-date conceptions saturated with the spirit of inflation. It is high time these conceptions should be abandoned. It is therefore very much to be welcomed that the Government of the Reich has now clearly and unmistakably declared in its Reply to the Agent General's Memorandum that it intends to make a clean sweep of these remnants of the inflation; and it is equally to be welcomed that the Government of the Reich declared on October 7, 1927, that "in view of the present position all expenditure which is not urgent or is uneconomic, whether to be effected by means of foreign loans or of other resources, must absolutely be avoided."

If we do not refuse to acknowledge the errors and mistakes which have been made and are prepared to learn from them, we shall be entitled to expect a just judgment on the part of foreign countries for the reason that no nation has ever been called upon to solve problems as difficult as those with which Germany has been confronted since the war. It will have to be



acknowledged that we have attacked the problem of recovering our pre-war social and economic position with superhuman self-sacrifice, an iron will to maintain order and unparalleled hard work, and that we have achieved more than anyone had reason to expect in view of the historical circumstances. Germany today is one of the most powerful contributors to the recovery of international welfare. In the future also we shall prove that we have the strength and the will, in the midst of the European political maelstrom, to remain a free, democratic, i.e., responsible nation, an axis around which the peaceful work of civilisation can revolve.

Referred to in letter of

797.2 a  
FIC 90.4

Translation.

Co-ord. Doc. No. 76 F

Deutscher Volkswirt  
November 18, 1927.

SELF-CONTROL.

By

Dr. Hjalmar Schacht, President of the  
Reichsbank.

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The memorandum of the Reparation Agent touches on the vital question of our nation. How many people realise this ? The Reparation Agent has been in Berlin for three years with the sole task of studying the capacity and willingness of Germany to pay in order, after the expiration of the four probation years which the Experts provided in the Dawes Plan, to render a judgment which will be of very great importance in the definitive settlement of the Dawes Plan. The Reparation Agent regularly records his observations in his semi-annual public reports. Who has read these reports, which pave the way for the decision on the life of the German people ? If they had been read more extensively, the memorandum could not have provoked among the public the surprise which it actually caused, and it would have been impossible to attribute the memorandum to any intrigue or any influencing by a third party. With unprecedented clarity the semi-annual reports show how the Reparation Agent interprets and carries out his task. Stability of the currency and budgetary balance are the two fundamental props which the Experts' Plan pointed to for the execution of reparation



payments. Again and again the reports refer to these two bases.

As early as May, 1925, the Reparation Agent deplored the accounting system of the Reich budget and its lack of clarity. Already in the report of November, 1925, he observes that the extraordinary receipt surplus has led to expenditures and made difficult opposition against the expenditure wishes of political circles. In the report of June, 1926, he again clearly points to the lack of clarity in the financial tables. The report of November, 1926, urges early and greater moderation in expenditures and criticises - as the report of June, 1926, had already done - the tendency of Reich, States and communes to grant loans and subsidies to industry and agriculture and to make capital investments in trade and industry. The report warns against tying up such surpluses and says that under certain conditions the practice may lead to borrowing merely because of faulty disposition of the Treasury. Without taking the position of fundamental opposition towards the application of an extraordinary budget, the report emphasises the dangers that dubious items may be financed, not out of current receipts, but out of extraordinary receipts, that is, loans.

The report of June, 1927, becomes very specially frank and detailed. Here the Reparation Agent begins by explaining his authorisation (perhaps doubt may have been cast on it upon occasion) to deal with the budget and for two reasons. Firstly, because the budget has to make available direct contributions to the reparation payments, and, secondly, because the Experts' Plan described a balanced budget as absolutely necessary for the economic recovery

of Germany and for her capacity to pay reparations, and, finally, because the transfer of the German payments to foreign countries is influenced by the equilibrium of the budget. Supplementing repeated complaints as to technique, the June, 1927, report contains almost all the ideas which recur in the memorandum, particularly the constant rise of expenditures and the incorrect basis of the financial settlement. This, too, is no new discovery of the Reparation Agent. Already in the November, 1925, report it is stated that the States and communes receive their payments out of Reich taxes without regard to their actual needs, so that some communes have been provided with a surplus of funds, whereas others are in financial distress.

The June, 1926, report emphasises, as did the preceding reports, the great importance of obtaining exact statistics on the financial conduct of the various States and communes. The November, 1926, report says very clearly that the strain apparent in the budgets of many States and communes will, it is hoped, have the healthy effect of reducing public expenditures; but that, in spite of this, borrowing on the part of the States and communes seemed at that time unfortunately to have a rising tendency. The same report says, finally, that the endeavours of the Reichsbank and the Reich Government to restrict at least foreign borrowings to some extent had been up to then without success. In the June, 1927, report, then, with express reference to the Dawes Plan which appeared three years previously, the Reich is once more reminded of its responsibility for a financial policy adjusted solely to the necessary requirements of the States and communes. All this does



not look as though the Reparation Agent had suddenly come to new conclusions, but shows an absolutely clear maintenance of the line originally envisaged.

We have the same experience if we follow the reports of the Reparation Agent with regard to principles of currency policy. In the question of the balances of trade and payments the May, 1925, report speaks of the object of recovering foreign markets and of the possibility of restricting unnecessary imports. The favourable trade balance of the preceding months is described in the June, 1926, report as extraordinary and too brief in point of time to permit conclusions for the future. Like the November, 1925, report, the November, 1926, report too appeals for a better understanding in Europe of the necessity of lowering trade barriers. The June, 1927, report points to the connection between import surplus and foreign borrowing and emphasises the stimulus to imports which foreign loans give.

The necessary but unfortunately lacking control of the public funds through the Reichsbank is a theme of the Reparation Agent which constantly reappears from the first report to the last. The November, 1925, report called attention to the nonsense of the Government acting as an investor in economic life by the use of the public funds instead of being a short-term ~~investor~~<sup>borrower</sup> on the open market, as is usual.

Thus the attitude of the Reparation Agent has been quite consistent from the very first moment in questions of currency and central banking, and it is only natural that he considers the issue

of the Reich loan in 1927 to be a thwarting of Reichsbank policy. Eight weeks before the sudden decision to issue a Reich loan, I said publicly before the Reichstag Committee for measures of subsidy that there was a great difference between the short-term money rate of the Reichsbank and the rates of the long-term capital market, and I pointed out the contrast between the liquidity on the short-term money market and the lack of absorptive capacity for long-term loans. When the Reich needs credit, I continued, it must consider whether it cannot go temporarily into the short-term money market and resort to it gradually to meet a portion of its needs so as to appeal to the long-term market for the satisfaction of these needs only in part. It was from this consideration that the Reichsbank caused a change in the Bank Law in July, 1926, providing for the possibility of re-discounting Reich treasury bills in order to facilitate a resort to the open money market on the part of the Reich. If use had been made of this possibility, what the Reparation Agent described as natural would have been accomplished, namely, through the Reich treasury bills there would, firstly, have been a natural temporary equalisation of the cash position of the Reich budget, and, secondly, a natural regulator of interest rates on the open money market. Moreover, the accumulation of great public funds, either from taxes or from loans, which constantly involved the danger of misuse, would have been avoided.

Anybody who has followed from report to report the more and more outspoken statements and warnings of the Reparation Agent must be filled with grave anxiety as to whither a policy of laissez faire is leading. Is not the example of the Prussian



loan, which the Reparation Agent mentions in his memorandum, a further proof what harm to our credit and our general standing can be done by this policy of letting things go ? In two letters written in September and November, 1926, the Reparation Agent expresses his opinion about the question raised by the first external loan of Prussia, with the result that when a year later a second external loan of Prussia is issued the question raised in the previous year is neither cleared up nor even discussed anew with the Reparation Agent. And then people wonder that the Reparation Agent raises objections to the issue of the loan and cannot explain his action in any other way than by suspecting the President of the Reichsbank of an intrigue.

What follows out of all this ? It follows that we must occupy ourselves much more intensively than hitherto with the actual and psychological factors providing an important basis for the formation of a judgment if, after the expiration of the four ~~past~~<sup>test</sup> years, we are to enter into a discussion of what has been accomplished up to that time under the Dawes Plan. The first danger which we face is that even now, as a result of a lack of interest on the part of the public, the warning of the memorandum may be unheeded. The second danger is that, instead of doing the most obvious and most necessary practical things in regard to such questions raised by the report of the Reparation Agent, as administrative reform, central control of local finances, etc., we may approach the matter from the viewpoint of the political disputes involved in federalism versus centralisation, and thus get into discussions of principle

which at best can lead to results at only a very late stage and after severe conflicts of internal policy. It is necessary and must be possible immediately to carry on a practical financial administration without raising the great questions of centralisation, because only such an administration can bring us closer to a definite solution of the Dawes Plan by peaceful means.

In earnest nobody doubts the good-will of Germany to pay reparations to the best of her ability, but good-will alone is not sufficient if there is not on hand sufficient strength to convert this will in reasonable measure into action. The Reparation Agent says that we are spending too much and borrowing too much, and there are many Germans who say the same thing. But there are also those who raise in reply to the warning to spend less and to borrow less the demand for an increase in purchasing power and for a greater inflow of capital in the form of credit; but, even if we were of this view, we should have either to convince the Reparation Agent that he is wrong, or we should have to seek to reach an agreement with his views, in spite of that, if we want to accomplish anything. And here it is not a question of words but of deeds. We must show the world by deeds that we can control ourselves. The German merchant enjoys an enormous credit in the world not only because he is considered honest and reliable, but primarily because he is rightly considered to have a sense of responsibility. Self-restraint and self-control are what the Anglo-Saxon holds in high esteem in forming a judgment of a man and what he demands of



intellectual and economic leaders. Let us show him that we have a sense of responsibility not only in business, but in political life, and that we know what self-restraint and self-control mean and are determined to exercise them.

## SUMMARY OF GERMAN PRESS COMMENTS ON THE NOTES EXCHANGED BETWEEN

### S<sup>3</sup> PARKER GILBERT AND THE GERMAN GOVERNMENT

November 1927.

A birdseye view of the comments shows a surprisingly large number that agree with Parker Gilbert's strictures in essence and urge thorough-going reform. Outspoken criticism and disagreement are relatively scanty. Under the main topics opinions in general agreement with the Agent General's point of view or indicative of a cooperative attitude are indicated by "For", and those dissenting or antagonistic by "Against".

#### GENERAL

##### For

The Deutsche Tageszeitung says that in spite of inner opposition in every good German the discussion may nevertheless be welcomed as an attempt to clarify financial and economic conditions which is entirely necessary. Another paper points out that "All have sinned", and leaving hypocrisy aside what we must now do is listen to the warning of the Agent.

#### FUNCTIONS OF AGENT GENERAL

##### For

Most of the papers agree that the Agent General has not exceeded his function, and that he has remained courteous and diplomatic throughout in his dealings. In fact "he expresses views remarkably similar to those of the President of the Reichbank."

Another remarks that it helps Germans to get over the sharp tone of the note to know they are dealing not with an enemy of the German people but with the Commissioner of the creditor powers who sees as a cool calculator and pure financier.

Germans are reminded that he is the agent for their creditors, whose duty it is to look out for the interests of his employers and to "tap the debtor warningly on the shoulder."

##### Against

Two or three papers term the financial supervision of what are German internal conditions, unjustified. The Agent has no right to be a "task master" or intervene in German internal political matters.

#### IDEAS ARE GERMAN IN ORIGIN

##### For

The Berliner Tageblatt says that many general and specific statements of the Agent General run parallel with domestic criticism for a long time on German financial policy. He says hardly anything that German critics themselves have not already said.

One paper suggests that as Mr. Gilbert has daily conferences and luncheon talks with many German leaders in business and industry probably they have expressed themselves too freely in criticism of existing conditions of which they disapprove and have thus given him an exaggerated idea of the situation.

Against The socialist paper "Vorwaerts" charges that Mr. Gilbert's views on the German public economy are due chiefly to "the materially unjustified attitude of the Reichbank, the large banks and the industrial leaders, who want to use the Dawes Commissioner in order to have stronger weapons against the hated competition of the public economy."

#### GERMAN GOVERNMENT'S REPLY

##### For

Most of the papers agree that the Government's reply was not at all equal to Parker Gilbert's note in forcefulness and that it represented a synthetic product of the various views of the Ministers which was not finally edited with a view to refuting effectively Mr. Gilbert's specific charges. It evades the issues.

The note scarcely touches on the grave question as to how the German states and communes are going to raise the money for their enlarged program.

The "clumsy attitude" of the Government as well as the contradictory statements of Dr. Koehler made Agent General say he viewed future with "grave anxiety."



## ADMINISTRATION

For

Government administration must be rationalized. There is a great waste in administrative relations between the Reich, states and communes which threatens to crush the nation. If the Germans do not put their own house in order, foreign control threatens.

So long as colossal malpractice in administration can be pointed to it is useless to refer to the oppressive burden of the Dawes plan.

Apparently no attempt is being made to provide for necessary budget expenditures by long-overdue administrative reform. The firm resolve of the Government to take action is not clear in its reply and yet it is necessary to do something. The "Berliner Boersen Zeitung" assumes that all political opposition will crumble in the face of the seriousness of the situation.

Against

One protest is made against the lack of information Mr. Gilbert displays in his criticism of government administration. He seems to know nothing of the Reich Audit Office.

## LOANS

For

Many papers emphasize the point that the loans to Germany have been for productive purposes. But the "Deutsche Volkswirt" points out that "the Government sticks to the primitive theory that use of a loan for electricity, gas, etc. suffices to prove it is productive. With this sort of economics the Government thinks it can answer a document, which aside from a few incidental points, is formally and theoretically impregnable."

Many of the loans in the interest of the whole people should not have been floted.

German money requirements are still large, so it is well to listen to Mr. Gilbert, whose judgement as to German conditions, the American business man holds in high respect.

Additional loans, as in the case of large credits to an industrialist will enable Germany to rehabilitate herself the faster and therefore be in a position to pay over much greater sums than otherwise would be possible.

The borrowing is really proof of desire to facilitate transfers.

It is feared that the discussions may affect loan possibilities, especially in the American market, and yet it would be to the advantage of the creditor nations to continue the loans.

Against

The loans to the communes have been for productive purposes and therefore should not be criticized.

Even if the loans have somewhat inflated credit they have stimulated business activity and reduced unemployment.

## STATE AND COMMUNAL FINANCES

For

Reorganization of state finances is needed but it is a slow process. Historical and political considerations are involved that apparently are not comprehended by the Agent General.

One paper questions to what extent foreign funds released other funds of the communes, which were then invested in notorious luxury enterprises instead of being used for necessary purposes.

Berliner Boersen Zeitung believes it might have been better if the Government had not tried to justify communal loan policy. Matters which were justified in a time of great depression are no longer valid today.

## BUDGETARY EQUILIBRIUM

For

No one except Dr. Koehler believes that the Reich will be able to finance salary reform next year without tax increases. Among the doubters is Parker Gilbert.



TRANSFERS

Against

The press is unanimous in the opinion that the question of transfers is not the Reich's business and that part of the memorandum must be firmly rejected. They believe it sufficient if they adopt no measures deliberately to hinder transfers.

The reactionary "Deutsche Zeitung" speaks of "the sneaky attempt to extend German responsibility, contrary to the clear sense of the Dawes plan, so as to include the transfer problem. The statements of the 'task-master' on this point must be rejected with all energy."

TRADE BALANCE

Against

It is not the fault of Germany if her exports are diminishing. Experts are hindered by trade policies and prohibitive tariffs of other countries. It is impossible to make payments to countries that will not receive German goods.

PRICES

Against

The Agent General is thought to have greatly exaggerated the effects of the new bills on the development of prices.

POLITICAL AND CULTURAL FACTORS

Against

Mr. Gilbert has ignored and misunderstood the political history of the many sections within Germany. He has also failed entirely to include cultural considerations in his criticism of expenditures.

The Reich government cannot be guided by financial and economic considerations alone but must also act under state political considerations.

DAWES PLAN REVISION

Against

A few guarded references appear as to the necessity for the revision of the Dawes plan, mostly confined to the counselling of tact and amenability to direction of the Agent General now in this crisis, so that he may be counted upon to advise the revision later.



November 11, 1927. Financial Control, by Gustav Stolper. (Mr. Jay comments that this is the best article.)

"We do not think it is admissible to load the political responsibility for the conflict and for its political and economic consequences on the Finance Minister alone. The whole Government is responsible, not only because it must bear the responsibility for German financial and economic policy, but also because the impossible reply to Parker Gilbert was brought before the Cabinet for its approval...The Government knew that Gilbert's memorandum would be published on Sunday morning by all the great newspapers of the world. What would have been more obvious than for the Government to try to meet the unfavourable effects of the document at the outset?...Nothing of the sort was done, and now we hear an echo stronger, more unanimous and more hostile than any German governmental document has aroused since 1924. The united front against Germany seems to be re-established, not at the cry of Nationalist ministers and generals, but in the name of economic reason, or, if that is preferred, of economic self-interest."

"The arguments of Gilbert are not all sound, but it would be the greatest mistake which people in Germany could make to try to meet these arguments by agreeing with them in a few points and in return criticising all the more severely some other matters of formulation. In so far as it does not accept the authority of the Reparation Agent and thus does not go into material questions at all, the rest of the world will take the opposite course. It sees primarily the faults in the German reply, which unfortunately talks around the Gilbert criticism in important points...The subject of his criticism - an entirely justified and incontrovertible criticism - is the fact that not even the attempt is being made to provide the funds for necessary expenditures primarily by a long overdue administrative reform... Foreign countries do not interpret the German words as an explanation of the motives of our action but as a threat, which the reply quite unnecessarily emphasises by saying that upon the settlement of all these matters depends the will of the whole people to pay...Foreign opinion does not understand that these expressions mean nothing at all. Why weaken the impression of the repeated honest assurance that Germany intends to fulfil her treaty obligations loyally?"

"In the report of June 10th, the Reparation Agent spoke very plainly, but he observed the polite form which is customary. A Finance Minister somewhat more familiar with the world would have understood what he meant. This report, too, was not a strong enough push to lead Dr. Koehler and the Government of the Reich finally to begin an exhaustive discussion with the Reparation Agent. For weeks and months no reaction whatever came from the Government. The June Report was ignored in exactly the same way as former signs of life from the Agent until the crash came with the Prussian loan...Naturally the Agent emphasises again and again that it is not his affair how Germany administers her budget. But unfortunately this country has creditors. In their relation to their debtors bankers do not let themselves be influenced by political considerations."

"That the Reich will be able to finance the salary reform next year without tax increases nobody in Germany believes except Dr. Koehler. Among the doubters is Parker Gilbert...Summarising, the Reparation Agent says that the Reich is endangering the stability of its budget, and that there is a general lack of effective control of public spending and public borrowing. These ideas are not strange to the readers of this paper...The note of the Government unfortunately goes beyond the line that can be defended with good reason. It sticks to the primitive theory that the use of a loan for electricity, gas, etc., suffices to prove it is productive, and says that the total 1.6 milliards of public borrowing abroad has not served to increase the administrative expenditure of the public corporations. With this sort of economics the Government thinks it can answer a document which, aside from a few incidental points, is formally and theoretically impregnable."



November 11, 1927. Financial Control, by Gustav Stolper. Cont'd.

"That the deficit in the trade balance is described, on the one hand, as the natural consequence of foreign borrowing, and that immediately following the statement is made that the German economy is still far from able to meet the deficit out of its own resources - that is the deficit in the trade balance is described as the cause of foreign credits - this is only a further example of the way in which a few anonymous officials put together their economic wisdom with a view to 'contradicting' the criticism of the Reparation Agent...Whether Parker Gilbert is called a bailiff or anything else for reasons of internal politics does not change anything. The important fact is that the German economy, the German people and the Reich are faced with the choice of living less well and being free, or of living in plenty and paying for it with a lack of independence and with the constant dangers which any debt relationship brings with it. A national financial policy is a financial policy of self-denial and sacrifice, not a financial policy of great words. The note of Parker Gilbert is no episode. It introduces, we hope, a new chapter of German history, the chapter of the great political reform, at the end of which stands German liberty."



VOSSISCHE ZEITUNG

(Democratic. Opposition. Writes a great deal on financial matters.)

November 6, 1927. "Made In Germany," by Georg Bernhard.

"Some of the Nationalist papers have again referred to the 'Dawes fetters' and have circulated a mean expression which characterizes the Reparation Agent as the 'task-master' of the German people. Parker Gilbert is not a task-master. Germany is not under financial supervision and the financial agent appointed for taking care of the rights of the reparation creditors has no right to intervene in internal German conditions. But he has the right and duty to look out for the interests of his employers. For they are the creditors of Germany. These creditors are not only reparation creditors. America, at least, is Germany's creditor as a result of her own free decision. Her banks and bankers have furnished Germany with milliards in the form of public loans and private credits. And even if Germany did not owe a pfennig of reparation debts, she would have to reconcile herself to the fact that her creditors would carefully watch the development of the public finances and of the German private economy and that they would express their opinion thereon."

"Germany's money requirements have by no means been satisfied as yet. On the contrary. We have always taken the view that without further large loans from abroad the German economy will be unable to develop. From this there follows the perhaps not very agreeable, but possible consequence that the important thing is not what conditions in Germany actually are but what opinion foreign countries have of German conditions. For it will depend on the judgment of particularly the Americans whether they wish to become larger creditors of Germany. And the extent to which Germany's reparation burden will be reduced depends on this judgment also. This is the reason why the statements of Parker Gilbert are so extraordinarily important...If Mr. Gilbert, who enjoys American confidence, expresses himself on German economic and financial conditions and if doubt as to Germany's credit arises out of such utterances, American business people consider these doubts in the same way as every business man in every country does who lends out money and whose experts express themselves in a doubtful manner on the credit-standing of the borrower."

"A possibility is that Germany, confiding in her economic, technical and mental forces, should accept as much foreign capital as she can obtain. With this capital she will again earn money and resurrect herself. And as a result of a prosperous German economy it will be easier to pay two milliards than one milliard under the other condition...Every thing depends on whether Germany considers herself a big industrialist or a small merchant."

"Ideas, which are entirely un-American, have influenced Parker Gilbert in Germany. His memorandum, which is adapted to cause distrust against German finances, is therefore nothing other than the exported product of German ideas. And unfortunately a large part of his memorandum must be prefaced with the remark: "Made In Germany."



FRANKFURTER ZEITUNG  
(Democratic. Opposition.)

Good paper - Represents old liberal spirit.)

November 5, 1927. (?)

"It is to be hoped this discussion will serve to make more clear to foreign countries the difference between the functions of German communes and those, for instance, in America. But, aside from this, it cannot be denied that the financial criticism of the Reparation Agent is largely justified, and that the clumsy attitude of the Government, particularly the contradictory statements of Dr. Koehler, has contributed towards making it possible for the Agent to say that he looks into the future with grave anxiety. We can only hope that no further encouragement from outside will be necessary to make the Government carry out the work of salary reform."

November 7, 1927.

"The firm resolve to take vigorous action is not so clear in the Government's reply, although all the difficulties which, it is explained, stand in the way of such a decision will not relieve us of the necessity of doing something... The problem is in effect that the outgrown relation between the Reich, the States and the communes and the great waste in this administrative apparatus threaten to crush us. Here we must take measures on our own initiative in the direction of unrelenting economy. For one thing has been made clear by the memorandum of the Reparation Agent, even to those who have up to now closed their eyes to it: we shall never be able to object against the Dawes Plan with any prospect of success and maintain that the internal payment of the charges placed upon us is impossible so long as we have not ordered our own affairs."

"The foreign borrowings of Germany are not a proof of a lack of will to fulfil reparations, but, on the contrary, a proof of a strong desire to make the reparations charges bearable and to facilitate transfers. During the period of transition we have been making ourselves strong in order to fulfil, in order to pay, in order to transfer. It is a misfortune that the Agent, insufficiently enlightened, did not see these facts... Practically speaking, we must now expect... that the inflow of foreign capital into Germany will be obstructed, and that, in particular, the American capital market will be less inclined at least to accept German public loans."



DEUTSCHE TAGESZEITUNG  
(Nationalist, Government Party.  
Leading organ of German agrarian interests.)

November 6, 1927. The Great Discussion, by Dr. Erich Wiens.

"In spite of all inner opposition which the memorandum of the Reparation Agent probably arouses in every good German and in spite of the feeling that Germany's dependency on foreign Powers is here brought home to us with a sharpness which we have experienced comparatively seldom during the past few years, the great discussion between the Reparation Agent and the Reich Government may in a certain sense nevertheless be welcomed as an attempt to clarify our financial and economic conditions, which is entirely necessary...The memorandum of the Reparation Agent has forced the Reich Government synthetically and fundamentally to treat the whole problem, - a thing which has long since been necessary for the education of the German people...What helps us Germans to get over at least part of the very sharp tone of the memorandum is the fact that we are not dealing with an enemy of the German people, but with the commissioner of the creditor Powers who believes he is only doing his duty in emphatically calling the attention of the Reich Government to the material pre-requisites for German reparation payments. The Reparation Agent is an American, and only with American eyes, i.e., as a cool calculator and pure financier, does he see and judge the intricate question of German reconstruction and reparation policy."

"While one-sided, Mr. Gilbert's concentrated attention to German financial policy, has given him the possibility of being an impressive critic who is undoubtedly competent in many things...It may be said that the objections of the Reparation Agent to the borrowing policy which a number of German communes have pursued during the past few years run entirely parallel with the misgivings which Germans have also advanced repeatedly...It may be true that on the books these foreign funds were used primarily for electrical and water works and for other productive purposes. Nevertheless the question remains open whether and to what extent foreign funds released other funds of the communes which were then invested in notorious luxury enterprises instead of being used for useful and necessary purposes thereby making borrowing abroad superfluous."

"We regret that in its reply the Government failed convincingly to refute the misgivings of the Reparation Agent against the wage and price effects of the salary reform...In warning against further increases in German costs of production, the Reparation Agent appears primarily to fear the unfavourable influencing of our trade balance. Naturally he must realize that the protective customs and trade policy of other countries is one of the chief reasons for the unfavourable status of the German trade balance, - a thing which our Government rightly emphasizes...When the Agent General appeals to the collaboration of the German Government for overcoming transfer difficulties, our reply refers with good reason to the hindrances not dependent on our will and influence...We take cognizance of the statement that the Reich Government is fortifying itself for a permanent equalization of the Reich budget in the pursuit of which aim the furthering of our economy will not suffer in any way. If in the execution of this program we should really arrive at an economic, financial and social policy which are attuned to one another and which supplement each other, we may look the step of the Reparation Agent and its consequences as an asset."

November 10, 1927. Transfer and Tribute.

"Aside from the tribute payments, we receive foreign exchange for all merchandise sold to foreign countries. At present we are receiving loans and short-term credits. Such drafts on foreign credit naturally result in a greater movement of merchandise from foreign countries to Germany. This is the explanation of our very unfavorable foreign trade balance...It is incorrect to assume that through foreign loans anything else is imported into Germany than more merchandise...~~It must not be forgotten that the same transfer will become possible before~~



GERMANY

(Centre or Catholic Party, Government. Important paper, as its editorial articles have considerable influence particularly on internal politics.)

November 6, 1927. Reparation Polemic or Reparation Business?

"It is particularly to be welcomed that the reply of the Reich Government is entirely in a tone of calm objectivity, which perhaps was not easy to maintain in view of the criticism which the Reparation Agent exercises. This criticism is all the more surprising because Parker Gilbert recognises that the assurances of the Government that it is doing everything in its power to meet its financial obligations are worthy of full confidence."

"The Versailles Treaty itself provides that Germany shall indemnify her citizens for their losses of property abroad; now when these indemnities are to be paid the Reparation Agent raises objections. It should therefore not surprise people abroad if the suspicion is aroused here and there in Germany that the Reparation creditors want to prevent the reconstruction of German existences abroad."

"It is one of the principal merits of the Dawes Plan that it took the reparation problem out of the stage of political discussion. It would be extremely regrettable in the interest of European peace if now a fruitless polemic should take the place of the business-like liquidation of reparations. We hope there is no reason for this fear. In spite of all objective opposition to the criticism of Parker Gilbert, we do not deny that in many other points there is agreement between his views and those of the Government."



DEUTSCHE ZEITUNG  
(Extreme reactionary.)

November 10, 1927. The Task Master, by Dr. Bang.

"The memorandum is noteworthy and fortunate because it lifts the veil from a condition which up to the present was still concealed to big parts of our nation in view of crafty propaganda....It gives us sincere pleasure that a description of the task master, which we created some time ago and for which we were reproached by the Dawes enthusiasts, is now going through the press 'the bailiff of the remains of a bankrupt Germany'. This hits the nail on the head...How stupidly and hatefully were we once opposed when we proved that the Dawes Plan aimed at gaining control of the German economy and power in the German State! At that time we also referred to the conquest methods of worshipped "America", i.e., of Wall Street capital, this greatest robber imperialist of all times. To-day we have the painful satisfaction of seeing this method of conquest uncovered with cynical open-heartedness in the book "Dollar Diplomacy" by Stearing and Freeman. Whoever wants to know what the Dawes Plan and the American loans mean should read this education book of Shylock."

"Of those people who helped to prepare the Dawes Plan and who accepted it, no one has the right to complain to-day and to shed crocodile tears. Parker Gilbert is merely doing his duty, and this duty is based on the 'voluntariness' of German policy of fulfilment. As regards the contents, the task-master is unfortunately right in some points. One does not have to be an American to recognize the untenability of a Social Democratic State and economic system which sacrifices to the Marxistic Moloch of 'public corporations' one private initiative after the other and which supports a robbing tax system and an unbounded loan policy to overfeed itself and to preserve the very dangerous condition of Marxistic party mal-administration. But the Reparation Agent's attack on the financial policy of the past year, i. e., on Koehler, is unjustified and malevolent."

"The most important and dangerous thing in the memorandum is the sneaky attempt to extend German responsibility, contrary to the clear sense of the Dawes Plan, so as to include the 'transfer problem'. The statements of the task-master on this point must be rejected with all energy. Why does the German Government not do this in its humble, obedient and lame reply?...The Government's reply does not say that which is important, necessary and a matter of course; that as a result of our bleeding we are at the end of our possibilities, and that 'by fulfilling' we have long since proved the 'impossibility of fulfilment', for which reason we must demand a change of things."



VORWAERTS

(Socialist. Bitter enemy of Nationalist and  
People's Party - also extremely hostile toward Communists.)

November 6, 1927.

"The criticism of the Reparation Agent is sharp in its contents but entirely courteous in its form...That the Reparation Agent continually speaks of extravagances of the States and communes is due to the fact that in the United States similar administrative forms with like tasks do not exist or exist only in a very small number. Mr. Gilbert's views on the German public economy are therefore due chiefly to the materially unjustified attitude of the Reichsbank, the large banks and the industrial leaders, who want to use the Dawes Commissioner in order to have stronger weapons against the hated competition of the public economy...We hope that the strained relations as a result of the exchange of documents will be overcome. But that such a condition could arise is the merit of a Government which through its composition and the undisciplined behaviour of the largest party in the coalition, has damaged the confidence of foreign countries in Germany's honest will."

HAMBURGER FREMDENBLATT

(Democratic. Opposition. Good paper of liberal views.)

November 5, 1927.

"The Government also says much that is right about salary increases, but one reads Dr. Kohler's statements with a feeling of dissatisfaction because they scarcely touch upon the grave question how the States and communes are going to raise the money. So far as the financial settlement is concerned, the Government has almost nothing material to say. The hollowiest, emptiest part of the reply is that about the cost of the school law...We must in general nevertheless recognise that a large part of the Reparation Agent's criticism is correct - with the proviso that he says hardly anything that German critics have not already said...If a discussion is now re-awakened, it will be of benefit to Germany, for the more clearly the German intention to fulfil the Dawes Plan is realised, the more favourable will be the judgment of foreign countries on Germany and her credit."

November 7, 1927.

"The Reparation Agent has looked at many things with the eyes of a foreigner for whom it is impossible to understand the complications of German financial policy. But just because Parker Gilbert is an American it ought to have been the endeavour of the Finance Minister to maintain close contact with him. There is no doubt that in such case public criticism of German financial conduct would have been omitted."



DEUTSCHE ALLGEMEINE ZEITUNG  
(People's Party, Government. Editorially the  
paper has little influence. Unimportant politically.)

November 6, 1927. By P. N.

"That the tone of the Reparation Agent's memorandum is, in spite of the unusual sharpness of the material, not unfriendly goes without saying in view of the correct relations between Parker Gilbert and the Reich authorities...As regards purely financial political problems, on the other hand, agreement ought to be possible all the sooner since the majority of the German people is of the view of the Agent General and the Government that very, very much must be simplified and improved in the public finances. We must only be given time to master the great difficulties which confront us."

November 7, 1927.

"It is questionable whether it would not have been possible to prevent the Reparation Agent from arriving at such an absolutely critical attitude and whether it would not have been possible for Germany to eliminate through her own free decision a number of the misgivings raised by Mr. Gilbert."

"The Dawes Plan as such is not the subject of debate to-day. Germany is, as the Reich Government has declared anew with all seriousness, determined to fulfil it. But the most important prerequisite for fulfilment is that increased merchandise exports be made possible for Germany. The difficulties and hindrances which other countries place in the way of German exports work in the direction of the destruction of the Dawes Plan because they make its self-evident pre-requisites questionable...It is not new that representatives of the German economy have requested the decisive authorities to rationalize the administration and the public corporations. In a very important interview at the end of September, Thyssen pointed to the danger if this most serious task is postponed until Germany was in the midst of critical negotiations on the bearableness of the Dawes burden and the fixation of the total sum of reparations. Such a procrastinating policy must, he continued, make our position very difficult...Unrestricted credits led Germany, to an extent, to over-estimate her own strength. Such a psychological reaction must not remain unheeded, and...a change of procedure is in order."

November 10, 1927.

"There is complete agreement between the Government of the Reich and the Reparation Agent that loans must be placed only for productive purposes. ~~In its reply~~ the German Government recognised the necessity of an early definitive ~~resolution~~ of the financial relations between the Reich, the States and the communes...The disturbance caused in many quarters in regard to the financial situation of the Reich lacks any foundation in fact. The German Government has already given the assurance that budgetary equilibrium will be maintained for the fiscal year under all circumstances. There can therefore be no suggestion that the equilibrium of the budget is endangered."



DEUTSCHE ALLGEMEINE ZEITUNG

(People's Party; Editorially the paper has little influence.)

November 10, 1927.

"There is complete agreement between the Government of the Reich and the Reparation Agent that loans must be placed only for productive purposes. In its reply the German Government recognised the necessity of an early definitive solution of the financial relations between the Reich, the States and the communes. . . . The disturbance caused in many quarters in regard to the financial situation of the Reich lacks any foundation in fact. The German Government has already given the assurance that budgetary equilibrium will be maintained for the fiscal year under all circumstances. There can therefore be no suggestion that the equilibrium of the budget is endangered."

KÖLNISCHE VOLKSZEITUNG

(Centre Party; Represents conservative wing. Important in its views on domestic politics.)

November 9, 1927. "In America's Shadow."

"France stubbornly refuses to ratify the agreements with England and the Mellon-Berenger agreement, saying that she receives no foreign exchange. For this the German deliveries in kind offer no substitute. Therefore by making more frequent and larger cash transfers to the reparation creditors, Gilbert places them in a position to be better able to meet their debt payments to America in cash. This is the one side.

"What is to be done? Nothing would be more incorrect than to arm ourselves with patriotism and morals. We intend to fulfil. But a nation which earns nothing cannot make any payments. Our economic structure is, moreover, much different from the American. Gilbert overlooked this."

November 5, 1927.

"It would have been politically, economically and financially unwise to raise a discussion on the practicability of the Dawes Plan at the present moment, or even to regard the exchange of memoranda as an occasion for doing so. The Government has therefore expressly stated its intention of carrying out the Plan...The payment of the reparation charges has not been endangered at any time and will not be endangered if the future budgets of the Reich are balanced. They will not be endangered in the future because the Minister of Economics and the President of the Reichsbank are taking steps to maintain the stability of the business condition."



KREUZZEITUNG

(Nationalist Government Party. Small monarchist paper.)  
Read chiefly by Army and Navy Officers.)

November 6, 1927.

"In spite of all attempts to make only economic and financial objections, the sharp reference to and criticism of Reich Government bills under discussions are very similar to intervention by Parker Gilbert in the sovereignty of the Reich...In view of the strained and obscure conditions in which we still find ourselves, this optimistic belief in the constancy of good business conditions is a very daring foundation for the Reich finances edifice. The Reich Government, however, cannot and will not let the present legislative measures drop. For it cannot be guided by financial and economic considerations alone but must also act under State-political considerations if it is to carry out its political tasks."

November 9, 1927.

"The memorandum of the Reparation Agent now published keep correctly within the limits of the powers given to him. There is no reason for attacks on him personally. Mr. Parker Gilbert raised in the memorandum no protest against the bills now pending, and he likewise refrained from making any concrete proposals. Nevertheless the gravity of the situation should not be under-estimated in any way. His warnings may have a great effect on credit conditions even now."

November 10, 1927. "What Does the Reparation Agent Want?"

"The question is why the Reparation Agent used such plain language. We have met our obligations to the limit, and our payments are fully secured, so that there is no doubt that they will be made in so far as the debtor is capable of paying at all...The important thing in the memorandum lies in the concluding remarks, in which he makes us responsible for transfers. This must be rejected... We have undertaken nothing more than not to make any financial manoeuvres or to adopt other measures deliberately intended to restrict transfers."

Brookdale Linen

U.S.A.



## BERLINER TAGEBLATT

November 7, 1927.

"The Tageblatt correspondent states further that it is remarkable that the Federal Reserve Bank of New York was able to give the American press the full text of the memorandum for publication in the Sunday newspapers. He thinks this makes it clear that the competent authorities want to bring the views of the Reparation Agent to the knowledge of the widest possible public. Other despatches from New York state that, whereas these papers publish the full text of the Agent General's memorandum, the reply of the German Government is given but little space..

"In the course of his speech at Liegnitz on November 5th the leader of the Democratic Party, Herr Koch pointed out that . . . the person who must take the initiative in the revision was the Agent General, who would have to prove in 1929 that the Dawes Plan could not be fulfilled. Only then would the time come for the great discussion with the Allies. Herr Koch went on to speak in favour of administrative reform, which, he said, could be accomplished only by establishing the unified state."

## REICHS-LANDBUND

The Reich Agrarian League (Reichs-Landbund) held a convention in Berlin, November 7, 1927.

Dr. Adametz, who spoke on administrative and constitutional reform, said:

"Frederick the Great once said that a clever person must not only do the right thing, but he must also do it at the right time. The responsible people in Germany missed the right time as regards a rationalization of our public administrations. If we do not ourselves soon put our own house in order, foreign control by foreign countries is threatening, which in practice has already - though at present cautiously - begun with the last action of the Reparation Agent, who under the Dawes Agreement has no right to intervene in German internal political matters.

"A part of the press attributes our sad financial situation exclusively to the oppressive burdens of the Dawes agreement. But we must be clear that we cannot refer to the oppressive burden of the Dawes obligations so long as - and not unjustly so - colossal malpractices in our public administrations may be pointed to."



HAMBURGISCHER KORRESPONDENT.

November 5, 1927. (?)

"One cannot evade the impression that this memorandum was worked out with the greatest care and thoroughness and that it will be of decisive importance for our whole financial and reparation policy. Moreover, it gives much better information about the actual status of finance and business than the very general statements of the German Government. Parker Gilbert says very hard words, but nevertheless we need not doubt that it is his intention to warn the German Government in time...If there is anything in the German reply that can be welcomed it is the part where the statement is made that Germany cannot adjust her whole economic situation to the execution of reparations. The Parker Gilbert memorandum is a work of eminent political significance; the German reply unfortunately is less political than bureaucratic."

RHEINISCHE-WESTPHALISCHE ZEITUNG

November 6, 1927.

"Parker Gilbert does not think his duties are confined to collecting the payments, but he believes he can take measures to prevent any possible complications. In other words, his right of interference with economic and financial affairs is unlimited. We can do very little against this control, which we ourselves accepted... In the reply of the German Government the whole impotence of an oppressed people is apparent."

KONIGSBERGER ALLGEMEINE ZEITUNG

November 5, 1927.

"Much of what he says is undoubtedly true, and it is bitter that we have to let a foreigner tell us these things only because we have not had the energy to act with the necessary resolution...We are glad the documents were published because distrust is now removed, but we expect that the German Government will now take the bull by the horns and use all its influence to restrain parliamentary bodies which show too much inclination to spend money. We must do everything to avoid the impression of bad will, because then we shall obtain an earlier revision of the Dawes Plan."



LEIPZIGER NEUESTE NACHRICHTEN  
(Nationalist. Unimportant politically.)

November 5, 1927. (?)

"The duty of the Agent General is to protect the interests of the creditor states, and, if he thinks these interests are endangered, he must tap the debtor warningly on the shoulder. Those who forced upon us the yoke of reparations ought to be the last to regard this as interference in our internal affairs. Parker Gilbert carefully avoids exceeding the limits of his functions... Aside from the schoolmasterly tone of his memorandum, which was perhaps not intentional, the Agent General expresses views remarkably similar to those of the President of the Reichsbank."

November 9, 1927.

"The Dawes Plan has left the responsibility for its success or failure to the German people. That is its psychological weakness. The Reparation Agent says nothing about this in his memorandum, and the German reply intimates nothing of the kind. Thus the Reparation Agent gets the upper hand even in the eyes of the German nation because the Government does not attack the fundamental idea of his memorandum."



MÜNCHENER NEUSTE NACHRICHTEN

November 7, 1927.

"The Reparation Agent has carefully kept within the formal limits of his office, but in fact he has told the Government that it is no longer responsible to the Reichstag but to the Dawes Plan. But his memorandum fails to prove that our financial policy has not been in the interest of the reparation obligations.

"We have long called attention to the impossibility of making payments to countries that will not receive our goods. The Dawes Plan will eventually fail because of this, but all these matters are beyond the control of the German Government. It would be a mistake if Germany should try to hasten this development artificially. But nobody can ask us to try artificially to slow it up."



KÖNIGSBERGER ALLGEMEINE ZEITUNG

November 7, 1927.

"We must say that even if the Government is right that it was necessary to increase the budget 1,700 millions in the past two years, what is going to happen if there should be really an economic depression when business can no longer pay taxes? If the Government's optimism is justified, the misgivings of the Agent will be largely overcome. But in the opposite case will not our creditors point to his warning and say that Germany has herself restricted her capacity to pay reparations? The German reply leaves the possibility of such an economic reversal entirely out of consideration, and that is the worst thing that can be said about it. Nevertheless the Agent must be told to keep within his proper limits in a number of points. . . . One statement of the Agent deserves the greatest consideration. Many people in Germany think that our obligations end with the payments to the Agent. We are now told coolly and objectively that we are obliged to facilitate transfers. There is no use denying the gravity of these matters. The consolation that the Government itself caused the exchange of opinions helps but little. Unless it takes into account the justified misgivings of the Agent, it will at least open itself to the reproach of having given the Agent a cheap opportunity to criticise things outside the limits of his office.

SCHLESISCHE VOLKSZEITUNG

November 7, 1927.

"If things were really as the Agent sees them, we should be in a bad way. We can only hope that he deliberately painted them too black. His criticism would have a disastrous effect on our foreign credit if it should be entirely approved, and if the reply of the Government does not convince the reader. We may expect that the measures promised by Dr. Kohler will dispose of the most important objections of Gilbert."

HANNOVERSCHER KURIER

November 8, 1927.

"There is an old proverb that anybody who contradicts somebody stronger than himself acts rashly. The Finance Minister acted in accordance with this proverb when he sent the Agent General a long reply to his memorandum.

"Mr. Gilbert's statement that what is in the interest of the German economy is likewise in the interest of the Plan is nonsense. So far as lack of any control over public expenditures is concerned, just the contrary is true. Gilbert seems to know nothing about the Reich Audit Office. He does not seem to understand anything about the finances of the States and communes. We are sorry the democratic press is exploiting the Agent's remarks. If we must dispute, let us do it among ourselves and be unified against foreign influences."



BÖRSEN COURIER

(Democratic; Opposition. Good financial paper with little political influence.)

November 8, 1927. "The Party Leaders on the Financial Dispute."

A leading Democrat says:

"Our well-known attitude and our criticism of the financial policy are only strengthened by the statements of the Reparation Agent. . . . If savings are to be effected, this must be done in connection with the necessary administrative reform, which must be carried out in the quickest possible way, preferably through the creation of a united State, which we have always advocated. In our opinion, savings may also be effected by reducing the expenditures of the army and navy."

A leading member of the Center Party says:

"The note of the Reparation Agent shows that the fundamental financial questions now pending must be settled before the beginning of the first reparation year. . . . If on the basis of Parker Gilbert's memorandum foreign loans become impossible, this would, in view of the necessary capital requirements of the economy for productive purposes, which cannot be raised within Germany, be fatal for the reparation payments which must be paid on September 1, 1928. But it is not to be assumed that anybody in Germany wanted to evade collaborating in reparations and in the transfer."

A leading economist of the People's Party says:

"The laws involved are the last step in the conclusion of the new order of German domestic conditions introduced by Dr. Luther and the necessary consequences of the currency reform and of the adjustment of German price conditions to the world index. . . . The result of the discussion on the possibility of fulfilling the Dawes Plan will be that the experts have considerably over-estimated Germany's capacity to pay and that they have under-estimated her capital requirements for the recovery of her economy. Germany's economic recovery would have to be broken off if she had to depend solely on the domestic market for satisfaction of her capital requirements. This would endanger not only reparations but also possibly the safety of foreign capital which has been loaned to us thus far. Foreign countries, and particularly America, will, in their own interests, therefore find it necessary further to collaborate in the German reconstruction process until it is terminated."

A leader of the Socialists says:

"It is regrettable that the Reich Government did not simultaneously present a plan on administrative reform in the Reich, and, what is still more important, that it did not reach a binding agreement with the States by which their greatly inflated administrations must be reduced. If the administrative reform had preceded the salary reform, it might have been possible to be more considerate of the justified wishes of officials. In my opinion there is no reason for uneasiness since the Reichstag is conscious of its duty and will see to it



that the budget in the coming years is really balanced and not balanced artificially through the inclusion of loans which it is impossible to float."

November 5, 1927. "Reich Simplification and Reparations by Dr. Cremer, Member of the Reichstag."

"When the total amount of the German reparation debt is fixed, the abolition of the present financial control may be brought about by supplanting the obligations of the Reich with a series of German loans, the proceeds of which would go to the countries entitled to reparations. As regards this goal, the intention of the Reparation Agent probably does not differ from the intention outlined here, and the interests of the reparation creditors would run entirely parallel here with German interests. But for the practical solution of the reparation question it will be of the greatest importance that at the given time confidence is placed in Germany that she will later pay the definitive sums which have been fixed in agreement with her. This confidence will depend on the judgment made on Germany's capacity and her good will."



BERLINER BOERSEN ZEITUNG

(Nationalist; Government Party. Good financial paper with little political importance.)

November 6, 1927. "Is Gilbert Right?" Dr. K.

"If the Reparation Agent makes the public finances the central point of his criticism, we must say, as the Reich Finance Minister actually does, that he is right in many points with regard to the ultimate aims. . . . It is regrettable that a stimulus is first required from outside in order to bring the development of certain financial political connections into more rapid flux for it may be assumed that political opposition will dwindle in the face of the seriousness of the situation which the memorandum of Mr. Gilbert illuminates.

"We should therefore like to assume that it might have been better for the Reich Government not to try to justify communal loan policy and that, it should have been pointed out that the large projects of the communes during the first years after the currency stabilization succeeded in helping the economy and a number of unemployed through a period of great distress. To be sure, matters which were perhaps justified in a time of very great depression are no longer valid today, and to this extent the criticism of the Reparation Agent on the public expenditures is unfortunately justified. Accurate as the judgment of the Reparation Agent may be in general financial-political matters, his criticism overlooks facts in important details. Entirely incomprehensible is his reproach of the Reich Government in the transfer question.

"The Reparation Agent may not be vindicated from great exaggerations with regard to the effects of the new bills on the development of prices."

November 6, 1927. Dr. J.

"As regards the form, the author of the memorandum uses the language and tone which is customary in diplomatic exchanges of opinion, without going a step beyond these limits. Mr. Gilbert is chiefly a warner, often something of a schoolmaster, unfortunately too much of a dictator, and hardly an adviser. Perhaps the Reparation Agent would not have used such sharp words if he had in the very beginning counted on the publication of the memorandum. The shortcoming most obvious in the train of thought of the Reparation Agent is a failure to consider those inner-State and internal political connections which form the basis of the most severely criticized financial political measures of the Reich Government.

"The financial laws must be carried out. This fact cannot be changed in any way by the memorandum. The Reich Government will, in conjunction with the parties, have to seek a compromise between this necessity and the objections of the Reparation Agent so far as they are objective and justified."



B.Z.

(Democratic; Opposition.)

November 7, 1927.

"The New York correspondent of the B.Z. adds that the memorandum will have far-reaching consequences on the attitude of America towards Germany, and that for the time being at least no German loans can be placed in New York. Even if investors were not disturbed through the controversy, the State Department would undoubtedly approve no more loans. The more serious consequence, however, he says, is that any hope of an early revision of the Dawes Plan must be given up for at least two years."

BERLINER TAGEBLATT

(Democratic; Opposition. Probably best Berlin newspaper from news point of view.)

November 6, 1927.

"Mr. Gilbert said that he hoped to render a service to the German Government and to the German economy as well as to the international situation by expressing his impressions and misgivings. For this good intention the German people must be grateful to him. Many of the general and specific statements of the Reparation Agent run parallel with the domestic criticism which has for a long time been made on the measures of the German financial policy. Even the Reich Finance Minister recognizes the justification of some of this criticism. . . . Things are not going forward rapidly enough in Germany. The tendency toward a unitarian State meets with political and certain economic hindrances for which the Reich Government has up to the present shown too much consideration. There can be no doubt that the idea of a unitarian State has of late gained ground. The Reich Government must make good use of this psychological situation and to this end, it must be less considerate than in the past of so-called insurmountable obstacles."



LE TEMPS.  
(Paris.)

November 7, 1927. "German Finances and The Dawes Plan."

"The Nationalist press in Germany committed a great error in reproaching Mr. Parker Gilbert with having exceeded his rights. It committed another error in maintaining that, if Germany should be unable to fulfil the Dawes Plan, the Reich would not have any responsibility. Mr. Parker Gilbert clearly indicates that it is the German Government itself that must bear the responsibility for its actions...If the memorandum of Mr. Parker Gilbert had had no other result than to make the Reich Cabinet declare categorically against the campaign in favour of revision, it would not have been in vain."



## SCHWÄBISCHER MERKUR

(People's Party; Government.)

November 7, 1927. "What are the Consequences?"

"It must be said that the German reply has one fault: it is too long and lacks any spirit: The efficient product of the officials of various Ministries was stuck together, but one can still see the cracks; and, since the reply was intended to have an effect abroad, it ought to have been "got up" more attractively!

"It would be a mistake to attack Parker Gilbert for taking the step to which, strictly speaking, he was not entitled. It would be a still greater mistake, however, to exploit the exchange for partisan purposes. Neither the Reich, the States, nor the communes, nor any one political party has any reason to feel like a Pharisee - all have sinned. What we must do now is to listen to the warning of the Agent; and, if the friendly exchange of views can have a fruitful effect, Germany owes Parker Gilbert thanks!"

## MAGAZIN DER WIRTSCHAFT

(Democratic; Opposition. Fairly reasonable.)

November 10, 1927. "Reply to Parker Gilbert."

"As to the necessity of more liberal commercial policies on the part of the creditor countries and the question of foreign borrowings, the statements of the Government must be approved. The Government rightly protests against the attempt of the Reparation Agent to ascribe to it an intolerable responsibility. But in the fundamental questions of German financial policy and the necessary constitutional reform the reply remains as unsatisfactory as the speech of Dr. Kohler."

## LOKAL-ANZEIGER

(Nationalist; Government Party. Reactionary.)

November 6, 1927. (K.F.)

"Even though it is right that many loans, especially of the communes, should in the interest of the whole people not have been floated, loan requirements cannot be denied categorically. The greatest misgivings must be provoked if the memorandum attempts to attribute to the Reich Government a responsibility, beyond the provisions of the Dawes Plan, for the execution of the transfer. A warning in this respect is not justified since the Reich Government has up to the present fulfilled all its obligations under the Dawes Plan.



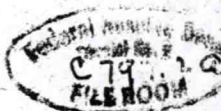
"The Agent General has made sharp criticism. It runs parallel on some matters with demands which have long since been made in Germany. His criticism, however, goes much too far on these points and fails to recognize political necessities. As the trustee of the creditor Powers, the Agent General has done his duty."

Hussong writes:

"We should like to see the negro state in which there are parties and people who would dare to defend an Experts' Plan on the basis of which its government would have to tolerate receiving such a letter as Mr. Parker Gilbert wrote to the Finance Minister of the German Reich. Our republicans do not reproach Parker Gilbert with a single word. He is not our trustee but the trustee of our enemies, yes, our enemies, if we are still allowed to call a cat a cat."

B

Referred to in memo  
I have been met to  
Go Strong  
12/2/27



XC261 a  
German