Keynes and the German Inflation

As is well known, John Maynard Keynes’s early celebrity as an economist owed less to any academic work than to his 1919 pamphlet, The Economic Consequences of the Peace, and the numerous pieces of journalism which he published on the question of reparations in the following years. That Keynes’s stance was—to put it crudely—‘pro-German’ hardly needs restating; though scholars differ as to the reasons for his sympathy. More controversial is the question whether his critique of the Versailles treaty was valid. This article seeks to show, firstly, that the extent of Keynes’s direct or indirect involvement with German governments has been underestimated. From 1919 until 1923, he was in regular contact with a group of Hamburg businessmen whose influence over German economic and foreign policy was very considerable. He proffered advice on how best the Germans might go about seeking revision of the peace terms; advice which was taken seriously and sometimes acted upon—most importantly in the summer of 1922, when he played a decisive role in the collapse of the policy of ‘fulfilment’. The second point to be made is that his advice was, on balance, bad advice. True, Keynes was right to argue that the economic burdens imposed on Germany at Versailles were excessive and that reparations required by the London schedule of payments were unsustainably high. But he miscalculated the ‘economic consequences’ in a number of important respects; and the courses of action he recommended to the Germans were, consequently, flawed. Indeed, it is not too much to say that Keynes encouraged the Germans to pursue policies which ultimately led to hyperinflation. To say the least, this sheds interesting light on his development as a monetary theorist.

As a young don recruited for wartime work at the Treasury, Keynes had become an influential voice in the making of British financial policy.1 It was therefore logical that he should find himself involved in preparations for the peace once it became clear that the Germans wanted an armistice. The question of reparations had long been a subject of public debate, in Britain as in Germany.2 In this debate, Keynes emerged as a believer in a relatively low indemnity, arguing as early as October


1918 that 20 bn. GM was a realistic total figure for reparations.1 Although he doubled this figure in the Treasury ‘Memorandum on the Indemnity Payable by the Enemy Powers for Reparation and Other Claims’ of December 1918, he continued to stress the problems that would arise from imposing such a burden. The Treasury memorandum acknowledged from the outset that even ‘if every house and factory and cultivated field, every road and railway and canal, every mine and forest in the German Empire could be carried away and expropriated and sold at a good price to a ready buyer, it would not pay for half the cost of the war and of reparation added together’.2 More importantly, it anticipated an argument which was to become central to the subsequent debate by distinguishing between ‘two eventualities’ which might arise from the transfer of reparations:

The first, in which the usual course of trade is not gravely disturbed by the payment, the amount of it being approximately equal to the sum which would accrue to the paying country abroad in any case, and would have been invested abroad if it were not for the indemnity; the second, in which the amount involved is so large that it cannot be paid without . . . a far-reaching stimulation of the exports of the paying country . . . [which] must necessarily interfere with the export trade of other countries. . . . In so far as this country receives the indemnity, there is a heavy off-set to this injury. But, in so far as the indemnity goes into other hands, there is no such off-set.

For this reason, Keynes advocated a policy of ‘obtain[ing] all the property which can be transferred immediately or over a period of three years, levying this contribution as ruthlessly and completely so as to ruin entirely for years to come Germany’s overseas development and her international credit; but, having done this, to ask only small tribute over a term of years.’3 However, the same memorandum also warned of the danger that a German fiscal crisis might lead to open debt repudiation or a break-up of the Reich.4 In short, Keynes’s intellectual reservations about excessive reparations were to a large extent established before he arrived in France for the armistice and peace negotiations.

There is, however, no question that a series of meetings with one of the German representatives at those negotiations added an emotional dimension to Keynes’s position. Carl Melchior was a partner in the Hamburg bank M. M. Warburg & Co.: a Jewish lawyer with a distinguished war record both on the battlefield and in economic policymaking.5 It may be that Keynes’s subsequent declaration that he ‘got to

1. J. M. Keynes, Collected Writings, Vol. XVI: Activities 1914–19. The Treasury and Versailles, ed. E. Johnson (London 1977), pp. 338–43. For the sake of clarity, all figures are quoted in ‘goldmarks’ (GM), i.e. 1913 marks (20.43GM = £1.00).
3. Ibid., p. 293.
4. Keynes, Collected Writings, xvi. 379.

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love' Melchior during the armistice negotiations at Trier and Spa obliquely alluded to a sexual attraction; but it seems more probable that Keynes was simply captivated by the sound of his own pessimism – the product of long-standing doubts about the morality of the war – being articulated by another.\(^1\) As Keynes later recalled, Melchior painted a bleak picture of a Germany on the brink of a Russian-style revolution:

> German honour and organisation and morality were crumbling; he saw no light anywhere; he expected Germany to collapse and civilisation to grow dim, we must do what we could; but dark forces were upon us. ... The war for him had been a war against Russia; and it was the thought of the dark forces which might issue from the Eastwards which most obsessed him.\(^2\)

The implication was clear: the Allies risked unleashing Bolshevism in Central Europe if they treated their vanquished foe too harshly. These arguments struck a resounding chord with Keynes. As the German Foreign Office official Kurt von Lersner observed, following Lloyd George’s intervention on the question of financing food imports to Germany: 'Thanks to Dr Melchior’s clear explanation, Herr Keynes has realized that there is a danger for the Allies in delaying [matters] and is trying to find common ground with us.'\(^3\) Significantly, in the immediate aftermath of the conference, Keynes warned that ‘an immediate rapprochement between Germany and Russia’ might be ‘the only chance [of] ... central Europe being able to feed itself’.\(^4\)

Because of his subsequently published memoir of Melchior, Keynes’s side of this story is well known; but Melchior’s is less so. No doubt Melchior was worried about the political situation in Germany: when he first met Keynes, his home town was under the control of a ‘Workers’ and Soldiers’ Council;\(^5\) and it was far from clear that the revolution of November 1918 was going to end in a compromise between Moderate Social Democrats, the more liberal ‘bourgeois’ parties and the old political, military and economic elites. Nevertheless, it seems clear that he was doing his best to exaggerate such anxieties for Keynes’s benefit. The group of businessmen who became involved in the German government’s preparations for peace were aware that they had little bargaining power. Melchior’s senior partner, Max Warburg, had demurred when asked by the last pre-revolutionary Chancellor, Prince Max of Baden, to represent Germany at the peace negotiations because ‘the Entente con-

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4. Keynes, Collected Writings, xvii. 119.
ditions would doubtless be extremely hard’.1 A week after the signing of the armistice, Wilhelm Cuno and Arndt von Holtzendorff of the Hamburg-Amerika (‘Hapag’) shipping line agreed that at the coming peace negotiations, there is scarcely any chance that we will be able to secure our objectives.2 The former Washington ambassador, Graf von Bernstorff, agreed that the German delegation would ‘achieve nothing... not the slightest thing’.3 Eugen Schiffer, the new Finance Minister, and Carl Bergmann, the Foreign Office’s reparations expert, talked of figures of 20 bn.M and 30 bn.M; but Warburg warned them to brace themselves for an ‘absurdly high’ figure. As he put it to the Foreign Minister, Brockdorff-Rantzau, in early April: ‘We must be prepared for damned hard conditions.’4 Having once anticipated imposing reparations of up to 100 bn.M on the Allies, he now assumed that Germany would be burdened with reparations for between twenty-five and forty years.5 The only way such a burden could be shouldered, argued Warburg, was by means of an international – i.e. largely American – loan to Germany, which would allow her to pay a fixed capital sum in annuities spread over a period of twenty-five to forty years.6 By April, he was envisaging a loan of 100 bn. GM, 25 bn. of which would be earmarked for the reconstruction of northern France and Belgium.7 The best argument to justify such a loan, the Germans believed, was the one outlined to Keynes by Melchior. As the President of the Hamburg Chamber of Commerce, Franz Witthoeft, noted, shortly after agreeing to join the Versailles delegation:

Bread and peace are the preconditions for order and work; otherwise we are headed for Bolshevism, and that will be the end of Germany. Yet I detect in this very danger of Bolshevism a certain safety-valve with regard to the efforts of the Entente to checkmate us absolutely. If this malaise spreads from Hungary over Germany, neither France nor England will be immune; and that means the end for all Europe.8


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Significantly, during a meeting with ministers in Berlin in late April, Melchior argued that 'leanings towards Russia' must be contemplated as a future diplomatic strategy for Germany; a view which was endorsed by the Reich President Friedrich Ebert. This was a very different tone from the apocalyptic one he adopted with Keynes.

Nor was Keynes the only Allied representative to be manipulated in this way. When the financial members of the German peace delegation arrived at Versailles on 28 March, they also sought to win over the American financial experts Bernard Baruch and Norman Davis. At the first meeting of the Finance Commission on 3 April, Melchior warned the Americans: 'My colleagues and I are Germans of the old-fashioned type and we are ... no longer able to persuade the masses, who listen to Russian agitators.' Two weeks later Warburg privately approached the J. P. Morgan partner and US Treasury adviser Thomas Lamont to raise again 'the question of Bolshevism. ... He must say again that the situation was growing hourly worse; and that the populace was so affrighted at the alleged terms of the Treaty set forth in the newspapers ... that no German delegation would dare to sign such a peace.' A memorandum Warburg then handed Lamont set out the German case in detail. If the treaty were too harsh, either a 'militaristic reaction' would lead to a 'war of revenge' or Germany would be 'driven into the arms of Bolshevism.' Two days later, Melchior issued a similar warning to Ellis Loring Dresel, another member of the American delegation:

He acknowledged freely that the result of refusing peace will be to plunge the country into Bolshevism but was quite clear that this was preferable to a dishonourable peace. He said if it were impossible to come to an understanding with the Western powers, obviously the only thing for Germany to do was to turn eastwards.

Like Keynes, the Americans appreciated that 'the problem [was] not so much what Germany can pay but what the Allies can afford to have her pay' and warned against making 'Germany pay a certain indemnity and

2. On the German delegation, see A. Luckau, The German Peace Delegation at the Paris Peace Conference (New York, 1941), pp. 188ff.; Haups, Deutsche Friedenspolitik, pp. 43, 51, 111, 397-404; id., 'Zur deutschen und britischen Friedenspolitik in der Krise der Pariser Friedenskonferenz', Historische Zeitschrift, cxxii (1971), 54-98. Cf. the comments in K. Schwabe, 'Versailles – nach sechzig Jahren', Neue Politische Literatur, xxiv (1979), 446-75. Alongside three ministers, a politician and an academic, Melchior was one of the principal delegates. The delegation of 'experts' which accompanied them (and which Melchior chaired) included Warburg himself; Witttheoef; Cuno; the Secretary of the Hamburg Chamber of Commerce, Eduard Rosenbaum; the Hapag director Richard Peltzer; as well as the head of the Bremen Norddeutsche Lloyd, Philipp Heineken. Significantly, there were only three representatives of heavy industry, and three of non-Hamburg banks.
5. Ibid.
6. National Archives, RG 59, 862.00/800, Dresel memorandum, 20 Apr. 1919.

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then making it impossible for her to pay.\textsuperscript{1} However, unlike Keynes, the Americans were privately sceptical of the German arguments (although Lamont may unwittingly have led Warburg on with his ambiguous remark that Germany would have a “rigged” peace).\textsuperscript{2} Warburg’s memorandum went down badly;\textsuperscript{3} and his requests for an informal meeting with President Wilson and his adviser Colonel House were denied.\textsuperscript{4} Indeed, it was primarily American opposition which led to the rejection of Keynes’s ‘Grand Scheme for the Rehabilitation of Europe’, which echoed Warburg’s call for a loan to Germany.\textsuperscript{5}

The most detailed — and, for Keynes, influential — statement of the German view came into the counter-proposals drawn up in May, at Warburg’s instigation, in response to the Allied terms.\textsuperscript{6} The central theme (developed in a ‘Supplement on Financial Questions’) remained that the Allied terms meant ‘the utter destruction of German economic life’, condemning Germany politically to ‘the fate of Russia’.\textsuperscript{7} Given the economic constraints being imposed on Germany by the peace — in particular, the loss of industrial capacity, colonies, overseas assets and the merchant navy — Germany could not pay war damages as defined by the Allies; and attempting to force her to do so would have dire consequences. On the one hand, to pay reparations from current government revenue would require that ‘expenditures for the payment of interest on the war loans, for the allotments of the disabled German soldiers and for the pensions of the dependents of the fallen soldiers, must cease or be cut down, as well as the expenditures for cultural purposes, schools, higher education, etc.’ This would simply ‘destroy’ German democracy: ‘Any ability and inclination to pay taxes would disappear and Germany would be for decades to come the scene of uninterrupted social class struggles of the bitterest kind.’ Financing reparations by borrowing, on the other hand, posed equally grave problems:

In the immediate future it will be impossible to place German state loans in large amounts either at home or abroad, so that compensation [to the owners of assets expropriated for reparations] could be made only by means of large

\textsuperscript{2} Schwabe, \textit{Wilson-Frieden}, pp. 562, 568, 582; WA, ‘Jahresbericht 1919’. Certainly, Lamont was anxious to prevent Warburg from publishing in his memoirs details of a conversation in which the American had allegedly said: ‘You better sign, as there is a paragraph of revision’; Baker Library, Harvard Graduate School of Business Administration, Thomas W. Lamont Papers 17-27, Memorandum, 30 Apr. 1945.
\textsuperscript{3} Lamont thought Warburg’s memorandum ‘an extraordinary document’, commenting to Baruch: ‘The nerve that these boche have is something terrible. I think you will agree with me that they are utterly lacking in insight into the real situation. ... The thing does not amount to anything’; ibid., Lamont to Baruch, 18 Apr. 1919.
\textsuperscript{4} Warburg, \textit{Aufzeichnungen}, pp. 73–8.
\textsuperscript{6} Text in Luckau, \textit{German Delegation}, pp. 306-406 (Document 57).
\textsuperscript{7} Ibid., pp. 319, 377–91; P. M. Burnett, \textit{Reparation at the Paris Peace Conference} (New York, 1940), ii. 78–94.

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issues of notes. The inflation, already excessive, would increase constantly if the peace treaty as proposed should be carried out. Moreover, great deliveries of natural products can only take place if the state reimburses the producers for their value; this means further issues of notes. As long as these deliveries last, there could be no question of the stabilizing of the German currency even upon the present level. The depreciation of the mark would continue. The instability of the currency would affect not only Germany, however, but all the countries engaged in export, for Germany, with her currency constantly depreciating, would be a disturbing element and would be forced to flood the world market with goods at ridiculously low prices.\(^1\)

To avert this, the counter-proposals laid out a set of conditions, such as the return of German territory, colonies and ships.\(^2\) Under these conditions, interest plus amortization could be paid in the form of annuities on bonds worth 20 bn. GM between 1919 and 1926; and amortization only in the form of annuities on bonds up to a maximum of 80 bn. GM - the annuities 'not [to] exceed a fixed percentage of the German imperial and state revenues'.\(^3\)

Whatever its significance for the history of Weimar foreign policy,\(^4\) the striking thing about this document is the way it foreshadows Keynes’s subsequent critique of the treaty. This is perhaps not surprising. We know that Keynes was impressed by the refusal of the German delegation to sign the unamended peace treaty.\(^5\) Indeed, he all but repeated the Germans’ prophecies of doom:

Germany’s … industry will be condemned to stagnation. … Germany will collapse economically … and millions of Germans will die in civil conflicts or will be forced to emigrate. … The result will be an ‘economic Balkans’ in the heart of Europe which will create endless unrest and constant danger of its spreading to the rest of the world.\(^6\)

Or, as Keynes put it:

The Peace is outrageous and impossible and can bring nothing but misfortune. … They can’t possibly keep the terms, and general disorder and unrest will result everywhere. … Anarchy and revolution is the best thing that can happen. … The settlement … for Europe disrupts it economically and must depopulate it by millions of people.\(^7\)

Nor was he out of touch with the Hamburg group during the period when he was preparing his own prophecies for publication. In October, he attended a small conference of bankers and economists in

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2. Ibid., pp. 388f.
3. Ibid., pp. 389f.
5. Keynes, *Essays in Biography*, p. 428; Harrod, *Keynes*, p. 238; Moggridge, *Keynes*, pp. 308, 311. Revealingly, he wrote to Duncan Grant on 14 May: ‘Certainly, if I was in the German place, I’d rather die than sign such a Peace.’
Amsterdam at the invitation of Max Warburg’s American brother Paul. The ostensible purpose of the meeting was the organization of large-scale commercial credits for Germany to facilitate imports of raw materials. But Keynes was eager to broaden the discussion. In private, he read a draft of *The Economic Consequences of the Peace* to Warburg and Melchior, who expressed great enthusiasm. Then, after further discussions with the others, he and Warburg jointly drafted an appeal to the League of Nations which effectively called for a reduction in reparations, the cancellation of war debts and a loan to Germany.

Although this document was endorsed when a larger group, augmented by Scandinavian and Swiss bankers, reconvened in early November, it was subsequently watered down as a result of pressure from the US Treasury on other American bankers invited to sign it. Indeed, even the modified call for an international financial conference was regarded as ‘objectionable’ in Washington since it risked awakening the hope ‘that the American people through their Government will be called upon to assume the burdens of Europe by U.S. Government loans’. This indication that the Americans were ‘determined to do nothing’ angered Keynes almost as much as his Hamburg friends. However, by the time the final version of the memorandum was published in January 1920, it had ceased to matter. It had been overshadowed completely by the appearance of *The Economic Consequence of the Peace*.

To say that Keynes’s argument in this book was the same as that put forward by the German financial experts at the conference would be to

1. Sterling Library, Yale, Paul M. Warburg Papers, Ser. II, Box 8, Folder 96, ‘History of the European Memorandum’. Those who attended were: Keynes; van Vollenhove, Vice President of the Bank of the Netherlands; C. E. ter Meulen, of Hope & Co., Amsterdam; Georges Raphael Levy, a Parisian Senator; and Fred I. Kent, then acting as the temporary American representative on the Reparations Commission. Vissering also invited Benjamin Strong; but Strong, although sympathetic, could not attend: Federal Reserve Bank of New York, Benjamin Strong Papers, 100/0/3, ‘Diary of a Visit to Europe’, pp. 111–15; 1150/0, Vissering to Strong, 21 Aug. 1919; Strong to Vissering, 23 Aug. 1919.
2. Ibid., 1000/3, Strong Diary, pp. 94 ff.; Sterling Library, Yale, Paul M. Warburg papers, Ser. II, Box 8, Folder 96 (which refers to an ‘American credit organisation to finance essential exports from the U.S. to European countries’).
6. NAW, RG 59 862. 51/1237 1/2, Paul M. Warburg, Confidential Memorandum: ‘Some Thoughts on Germany’s Financial Future’, 5 Nov. 1919; Sterling Library, Yale, Paul M. Warburg Papers, Ser. I, Box 5, Folder 59, Paul Warburg to Norman Davis, 17 Nov. 1919; Davis to Warburg, 26 Nov. 1919; Paul Warburg to Norman Davis, 29 Nov. 1919; and the versions of the document in Folder 61.
7. Ibid., Folder 60, Norman Davis to Paul Warburg, 7 Jan. 1920; Warburg to Davis, 12 Jan. 1920; Herbert Hoover to Warburg, 10 Jan. 1920; Carter Glass to US Chamber of Commerce, 28 Jan. 1920; Warburg to Leffingwell, 4 Feb. 1920; Box 61, Warburg to David Franklin Houston, 3 Mar. 1920.
exaggerate. But the resemblances are very close; and nor did Keynes deny their influence on him.  

1. Like them, he blamed the French for the ‘Carthaginian’ economic provisions of the treaty and denounced the Reparations Commission as ‘an instrument of oppression and rapine’.  

2. Like them, he insisted that Germany ‘had not surrendered unconditionally, but on agreed terms as to the general character of the peace’ (the Fourteen Points and subsequent American notes).  

3. And like them, he stressed that the loss of Germany’s merchant marine, her overseas assets, her coal-rich territories and her sovereignty in matters of trade policy severely limited her capacity to pay reparations. The Allies claimed compensation for damage and pensions amounting to 160 bn.GM, which an asset-stripped Germany could only hope to pay out of her export-earnings. Yet to turn the traditional German trade deficit into a surplus would put pressure on Allied business, while necessitating intolerable reductions in German consumption. Even if Germany were left with her essential assets (including the Silesian coalfields), 41 bn.GM was the most she could be expected to pay, three-quarters in the form of interest-free annuities spread over thirty years.  

4. Nor did Keynes omit the apocalyptic warnings he had heard from Melchior at Versailles, predicting a Malthusian crisis in Germany and the inflation-led destruction of capitalism in Central Europe:

The policy of reducing Germany to servitude for a generation, of degrading the lives of millions of human beings, and of depriving a whole nation of happiness [will] ... sow the decay of the whole civilised life of Europe. ... ‘Those who sign this treaty will sign the death sentence of many millions of German men, women and children.’ I know of no adequate answer to these words. ... If we aim deliberately at the impoverishment of Central Europe, vengeance, I dare predict, will not limp. Nothing can then delay for very long the final civil war between the forces of Reaction and the despairing convulsions of Revolution, before which the horrors of the late German war will fade into nothing, and which will destroy, whoever is victor, the civilisation and the progress of our generation.

5. Nothing short of ‘a general bonfire’ of international debts and a German-led programme of economic reconstruction in Eastern Europe, he argued, would avert these calamities. Strikingly, Keynes advocated a German eastward orientation, arguing that only German ‘enterprise and organisation’ could reconstruct Russia:

1. Ibid., p. 3: ‘Those connected with the Supreme Economic Council [had] ... learnt from the lips of the financial representatives of Germany and Austria unanswerable evidence of the terrible exhaustion of their countries.’  

2. Ibid., pp. 25, 204.  

3. Ibid., p. 51.  

4. Ibid., pp. 102–200, 249f. These generous provisions make it hard to understand Keynes’s dismissal of the German reparations counter-offer as ‘somewhat obscure and also rather disingenuous’ (p. 204). According to his own calculations, the present value of the 100 bn.GM proposed by Warburg and Melchior had been 30 bn.GM, since they envisaged the sum being paid over a prolonged period, beginning in 1926, in annuities of which only a fifth would bear interest.  

5. Ibid., pp. 209, 212, 251.
Germany’s ‘place in Europe’ was ‘as a creator and organiser of wealth for her Eastern and Southern neighbours’.¹

Not surprisingly, the publication of Keynes’s book – and its enormous success – was hailed as a breakthrough in Hamburg, auguring a sea-change in British opinion. Melchior thought it ‘magnetising’ and ‘a landmark for a new development in ... post-war history’.² In this he was certainly right. Keynes’s attack on the Versailles treaty without question contributed to that guilty feeling of having wronged Germany which so inhibited British diplomacy in the 1930s. Only the bitter experience of the Second World War called his version of events into question,³ paving the way for the revisionist work of more recent scholars like Marks, Schuker and Kent.⁴ Yet if contemporaries had read Keynes more closely, this revision might have come a great deal sooner. For his analysis was repeatedly belied by events; and only by conducting running repairs through his journalism was Keynes able to keep his reputation as sage intact.

Admittedly, events immediately after Versailles initially seemed to vindicate Keynes. Firstly, the mark slumped against the dollar from 14M/$ to 99M/$ between June 1919 and February 1920, mainly because of the decision of the new Economics Minister, Robert Schmidt, to lift exchange controls.⁵ Schmidt was explicit about what he hoped to achieve: ‘The tossing out of German goods abroad at slaughter prices ... will compel the Entente to allow us to bring our exchange into order.’⁶ In the short term, there clearly was substantial dumping of German goods, as the available monthly figures for 1919 and 1920 indicate.⁷ At the same time, Bolshevik successes in the Russian Civil War and continuing social unrest in Germany prompted renewed prophecies from Melchior of ‘a kind of League of the Vanquished ... between Russia and

¹. Ibid., pp. 270–6.

². Keynes, Collected Writings, x. 427f.


Germany’.\(^1\) Yet by the spring of 1920, both trends had been reversed. Instead of spiralling inexorably downwards, the mark suddenly recovered; and instead of the wave of Bolshevism sweeping into Germany, Polish troops swept into the Ukraine, while in Germany there was an attempted conservative *putsch*.

The truth was that the economic consequences of peace were far less severe for Germany than Keynes had claimed. Apart from the US, all the combatant countries had emerged from the war with heavy losses on their capital accounts.\(^2\) Germany’s total reparations burden had not yet been determined; but the money owed to the US by the prospective recipients of reparations already amounted to around 40 bn.GM.\(^3\) Similarly, it was not just Germany which had lost shipping: the total losses to world shipping during the war (the better part of them inflicted by Germany) had totalled more than 15 m. tons.\(^4\) In any case, the significance of these lost assets should not be exaggerated:\(^5\) shipping in particular was swiftly replaced. In the short run, the world economy boomed as businessmen rushed to replace inventories and plant run down during the war, and as trade links were restored which front lines, warships and submarines had disrupted. By 1920, international trade had recovered to 80 per cent of its pre-war level.\(^6\) The monetary expansion generated by war finance, which had led to accumulations of cash balances in all the combatant economies, fuelled this upswing. According to one estimate, German NNP grew by 10 per cent in 1920 and 7 per cent in 1921.\(^7\) Although German agriculture continued to languish, indicators of industrial output show a sharp upward trend: up 46 per cent in 1920 and 20 per cent in 1921, with certain industries (notably shipbuilding and coal) experiencing especially rapid growth.\(^8\)

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5. The real annual losses in invisible income due to the peace terms have been estimated at just 200 m.GM; Kent, *Spoils of War*, pp. 9ff. However, Kent’s figure of 40 m.GM for the annual income from German foreign securities surrendered to the Allies is too low; the correct figure must be in the region of 800 m.GM.
From a foreign point of view, this combination of rapid growth and a weak exchange rate appeared contradictory, and invited speculation.\(^1\) As a result, the German trade deficit in 1919–20 was financed not by large-scale foreign loans, but by numerous, small-scale purchases of paper marks by foreigners. Foreign deposits at the seven Berlin great banks rose from 13.7 bn. M in 1919 to 41.6 bn. M in 1921, and accounted for almost a third of total deposits.\(^2\) Purchases of marks in New York totalled 60 m. GM between July 1919 and December 1921.\(^3\) Keynes was dimly aware of this. In October, he heard that ‘the aggregate foreign holding of marks has now reached the prodigious figure of 20 milliards’. ‘The speculation’, he noted three months later, was ‘on a tremendous scale and was, in fact, the greatest ever known.’\(^4\) But he clearly overlooked the likely impact it would have on the exchange rate. In March 1920, the mark suddenly ceased falling against the dollar and rallied, rising from a rate of 99.11 M/$ to a peak of 30.13 M/$ in June. In the months after March, all the trends of the previous eight months were reversed: export prices rose, and the gap between German prices and world market prices abruptly closed.\(^5\) This not only stopped the German export drive in its tracks.\(^6\) It also cost Keynes over £20,000 (most, but not all, his own) which he had invested on the assumption that the economic consequences of the peace would be as he had forecast.\(^7\) It was not until some time later that he fully grasped what had happened:

[From] itinerant Jews in the streets of the capitals ... [to] barber’s assistants in the remotest townships of Spain and South America ... the argument has been the same. ... Germany is a great and strong country; some day she will recover; when that happens the mark will recover also, which will bring a very

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large profit. So little [he added bitterly] do bankers and servant girls understand of history and economics.¹

Perhaps not surprisingly, when his opinion was sought on the reparations question some months after the mark’s recovery Keynes declared himself ‘much too pessimistic at the present stage of affairs to be of the slightest practical use of anyone’.²

This uncharacteristic reticence did not, however, last long. The setting of the final reparations bill – postponed at Versailles because of Allied dissension – swiftly roused Keynes from the obscurity of King’s. At Paris in January 1921, the Allies agreed on a scheme for reparations totalling 226 bn.GM, to be collected by annuities rising from 2 to 6 bn.GM, and an additional payment equivalent to 12 per cent of German exports.³ Three months later, after much haggling and prevarication, a definitive total bill was set at 132 bn.GM, backed by the threat that the Ruhr would be occupied if the Germans did not submit. This ‘London Ultimatum’ demanded that, beginning at the end of May 1921, Germany pay interest and amortization on ‘A’ and ‘B’ bonds totalling 50 bn.GM in the form of a 2 bn.GM annuity, due quarterly. It also specified that, beginning in November 1921, a payment equal to 26 per cent of the value of German exports should be made. As German exports in 1920 had been estimated at around 5 bn.GM, this implied a total annual payment of around 3 bn GM. When German exports had reached a level sufficient to pay off the ‘A’ and ‘B’ bonds, non-interest-bearing ‘C’ bonds with a face value of 82 bn.GM would be issued. The 12 bn.GM still outstanding from the 20 bn.GM demanded at Versailles was tacitly included in this total, while sums due to Belgium were not, so that the sum outstanding was 123–126.5 bn.GM.⁴

Keynes’s response to the London schedule involved some rough national-income accounting. He estimated the burden of reparations at between a quarter and a half of national income which, in purely fiscal terms, he considered impossibly heavy. ‘Would the whips and scorpions of any government recorded in history have been potent enough to extract nearly half their income from a people so situated?’ he asked readers of the Sunday Times.⁵ However, he devoted more attention to the balance of payments implications, or what would later be called ‘the

¹ J. M. Keynes, ‘Speculation in the Mark and Germany’s Balances Abroad’, ibid. xviii. 48.
⁴ Maier, Recasting Bourgeois Europe, pp. 241ff.; Kent, Spoils of War, pp. 132–8; Marks, ‘Reparations Reconsidered: A Reminder’, pp. 356f. Webb suggests that 4 bn. GM was the real annual burden because of occupation costs and ‘clearing’ payments: Hyperinflation, pp. 194f.
transfer problem'. The Allies expected to be paid their annual indemnity in gold-convertible foreign currency, not depreciating paper marks. But this could only be obtained if Germany ran a balance of payments surplus. Keynes was increasingly sceptical about the possibility of a loan from abroad to facilitate matters: by the time of the Genoa conference in April 1922 (which he covered for the Manchester Guardian), he dismissed the German proposal for an international loan as 'an illusion [as big] as reparations on a grand scale'. Nor did he believe that payments in kind (as envisaged by Walther Rathenau) could ease the situation. In his view, the transfer could only be achieved via a German export surplus. But this he regarded as an impossibility, in view of the country's large post-war appetite for imports. In any case, he added, reverting to the arguments of 1919,

[even] if Germany could compass the vast export trade which the Paris proposals contemplate, it could only be by ousting some of the staple trades of Great Britain from the markets of the world. ... I do not expect to see Mr Lloyd George fighting a general election on the issue of maintaining an Army to compel Germany at the point of the bayonet to undercut our manufactures.4

In other words, the schedule of payments was unworkable. In the short term, Germany would only be able to raise the monthly payments by selling paper marks on the foreign currency markets; but this would inexorably drive down the exchange rate until the process became unsustainable. When the mark slumped against the dollar from 62.30 M/$ in May to 262.96 M/$ in November, he was therefore not surprised. Despite his losses in 1920, he remained a pessimist about the mark – unlike most foreign investors who, judging by the forward exchange rate against the mark in London, and figures for purchases of marks in New York, remained optimists until mid-1922.5 In this, he

5. Keynes, 'Will the German Mark be Superseded?', in Collected Writings, xviii. 1–6. On the forward exchange rate and foreign holders of marks, see Holfrich, Inflation, p. 73. On foreign purchases of marks in New York, see Webb, Hyperinflation, p. 57. Estimates of the total capital inflow in the inflation years include Keynes's (12–15 bn.Gm), Graham's (15.6 bn.GM) and Holfrich's (15 bn.GM). Cf. C.-L. Holfrich, 'Internationale Verteilungsfolgen der deutschen Inflation', in Kyklos, xxx (1977), 271–292; id., 'Amerikanischer Kapitalexport'; id., 'Die deutsche Inflation 1918 bis 1923 in internationaler Perspektive', in Historische Prozesse, p. 327; Schuker, 'American "Reparations"', pp. 365–8. Keynes and the McKenna committee sought to distinguish between purely speculative purchases of paper marks (2–3 bn. or 0.7 GM); foreign accounts in German banks (3 or

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believed he was in tune with the German mood; by August 1922, he was estimating total German 'flight capital' (i.e. overseas investments) at 1–3 bn. GM.¹

In fact, Keynes substantially overestimated the burden of the London schedule of reparations. Firstly, as more recent writers have argued, the 'present value' of the 'C' bonds was notional, since it was unclear when they would come into operation.² Secondly, compared with Keynes's 25–50 per cent, the latest estimates of the potential burden on national income of the annuity vary from just 5 to 10 per cent, which one historian has called 'not intolerable'.³ On the other hand, the annuity initially envisaged was certainly a bigger proportion of national income than that subsequently paid under the Dawes plan (at peak, around 3 per cent); and far outstrips the burdens imposed on developing countries by international debt in the 1980s, let alone the sums paid by Western countries in the form of aid to the Third World.⁴ And Keynes was certainly right that it would prove difficult for Germany to run a trade surplus. Estimated annual figures point to a trade deficit of around 690 m.GM in 1921 and over 2,000 m.GM in 1922, compared with a tiny surplus in 1920.⁵ Monthly figures provide a more precise record: the trade gap widened between May and September 1921; narrowed to record a small surplus in December 1921; and then widened again to reach a peak of 348 m.GM in July 1922. The figures for trade volumes

8 bn.GM; short-term business credits (0.5 or 1 bn.GM); and investment in German securities and real estate (1 or 1.5 bn.GM). But these figures are little more than guesses. One of the many problems which arise is estimating the real value of any interest and dividend payments made to foreign lenders.

¹. In August 1922, The Times estimated German foreign investments at close to their pre-war level, but Keynes dismissed this as a gross exaggeration, suggesting 1–3 bn.GM as a plausible figure: 'Speculation in the Mark and Germany's Balances Abroad', 28 Sept. 1922, in Collected Writings, xviii. 56ff. He later revised this upwards to 1.7–3.8 bn. GM: The Nation and Athenaeum, 19 Apr. 1924. The McKenna committee ultimately opted for a figure of 1.7–7.8 bn. GM for total German capital abroad at the end of the inflation period, but this figure too was little more than an educated guess: Schuker, 'American Reparations', p. 366. Cf. The Economist, Reparations Supplement, 12 Apr. 1924.

². Marks, 'Reparations Reconsidered', passim; Maier, Recasting Bourgeois Europe, pp. 24ff. One contemporary estimate of the present value of the London schedule put it as low as 49 bn. GM.


⁵. There are a number of quite different calculations to choose from, beginning with Keynes's estimates in Collected Writings, xviii. 48, 54; Statistik des Deutschen Reiches, vol. cccxvii (Berlin, 1924), p. 5; Laursen and Pedersen, Inflation, pp. 681, 83, 89–91; Holtfrerich, Inflation, p. 212; id., 'Germany and the International Economy', p. 276; and Webb, Hyperinflation, pp. 76, 91. Though all clearly indicate an increased deficit in 1921, Holtfrerich and Webb follow the Statistik des deutschen Reiches in arguing that there was a near balance in 1922. However, the relevant figures are arrived at by converting volume figures into 1913 unit values using the customs schedule of 1913, which makes no allowance for the dumping of German exports at very low prices. My own calculations based on monthly data for volume as well as value suggest that the deficit grew to around 2 bn. GM in 1922, close to the estimate given by Laursen and Pedersen.
tell the same story, but suggest an even more dramatic widening of the deficit after February 1922.¹

The fiscal implications of the London schedule also support Keynes’s argument. According to German budgetary data, total real expenditure under the terms of the Versailles treaty in the years 1920 to 1923 amounted to between 6.54 and 7.63 bn.GM (compared with the 12 bn.GM which the Allies had hoped to receive, assuming a constant annual payment of 3 bn.GM). This amounted to 20–25 per cent of total Reich revenue; 20–25 per cent of total Reich spending; 10–13 per cent of total public spending; and 4–5 per cent of national income.² It is possible to conceive of a government raising sufficient funds from taxation and bond issues to cover total Reich expenditures of 30–35 bn.GM in a non-inflationary manner; or cutting expenditure on social programmes in order to finance reparations.³ But it would have needed to be a far more authoritarian regime than that of early Weimar.⁴

In short, the London schedule was, as Keynes and the Germans maintained, unsustainably onerous: the 21 bn. GM total he suggested in December 1921 was without doubt more realistic.⁵ Nevertheless, the German government’s reluctance to balance the budget went far beyond the limits implied by such calculations. As Chancellor Wirth himself put it in arguing against a property levy (or ‘seizure of real values’, in the contemporary catch-phrase): ‘The goal of our entire policy must be the dismantling of the London Ultimatum. It would therefore be a mistake if, by initiating a seizure of real values at this moment, we were [in effect] to declare the Ultimatum to be 80 per cent possible.’⁶ The domestic debate on financial reform between May 1921 and November 1922 was therefore a phoney debate, as the Chancellor himself was not in earnest about trying to balance the budget. This explains why proposals like that for the ‘seizure of real values’ – which was initially conceived as a compulsory mortgage on all immobile property, then as a capitalized corporation tax – failed to raise adequate amounts of revenue. Such


⁵. J. M. Keynes, A Revision of the Treaty (London, 1921). This represented a return to Keynes’s original estimate of October 1918, and would have implied payment of 1.26 bn.GM for 30 years.

schemes had to be discussed in order to appease the Reparations Commission; but they were never intended to 'close the hole in the budget'.

Similarly, the idea for a 1 bn. GM ‘forced loan’ was devised primarily in response to the Allies’ demand for a financial reform plan at Cannes; but the Finance Ministry fixed the multiplier for converting paper marks into gold at 70, so that the tax ultimately yielded only 50 m. GM. State Secretary Fischer captured the prevailing mood when he described the Reparations Commission’s ‘wish for a further increase in taxes’ as implying a ‘wish for the economic destruction of Germany’. Real income from taxation actually fell in the second half of 1921, and rose only slightly in the first half of 1922; so that although the deficit was falling as a percentage of NNP (from 16 per cent in 1920 to 12 per cent in 1921 and 9 per cent in 1922), it remained excessive by modern standards. Keynes’s problem may have been simply that he trusted the Germans. In November 1921, responding to the allegation that the Germans were deliberately exacerbating inflation to undermine reparations, he wrote: ‘I do not believe a word of the silly stories that the German government could be so bold or so mad as to engineer on purpose what will in the end be a great catastrophe for their own people. Yet this is exactly what was going on. The Germans believed that through continued deficits and continued currency depreciation they would achieve higher exports; and these would, in the words of Melchior, ‘ruin trade with England and America, so that the creditors themselves will come to us to require modification’. At last, by late 1922, it appears to have begun to dawn on Keynes that the Germans were being disingenuous. When Wirth invited him to Berlin to review the German stance as one of a committee of experts, he was openly critical of the government’s failure to ‘control the budgetary position’. Indeed, he appears to have all but reversed his stance at around this time, repudiating ‘the point of view which looks first to the balance of trade … or alternatively to the support of a foreign loan’. Donning the mantle of fiscal orthodoxy, he wrote to the Reichsbank President Havenstein in December 1922: ‘If I felt confident that I could control the budgetary position, I should not doubt my capacity … to control the exchanges. As soon as the supply of new currency is

1. Ibid., pp. 69–71; Maier, Recasting Bourgeois Europe, pp. 247–55; Kent, Spoils of War, p. 147.
5. Keynes, ‘Renewed Depreciation of the Mark’, 9 Nov. 1921, in Collected Writings, xviii. 10.
8. Ibid., pp. 116ff., 120.
limited, I do not see how it is possible that the balance of trade should be adverse.\textsuperscript{1} This was a very Keynesian way of admitting error.

One might have expected Keynes to have distanced himself from events in Germany at this moment of disillusionment. On the contrary: he was about to reach the zenith of his influence. This may be said to have come at the Hamburg Overseas Week, which began on 17 August 1922: on the surface, an exercise in civic pomp attended by President Ebert, the ministers Groener and Köster, various diplomats and numerous Reichstag deputies; behind the scenes, an unofficial conference on German foreign policy, with Keynes as the guest of honour.\textsuperscript{2} The Overseas Week was the idea of his old friends Warburg and Cuno,\textsuperscript{3} and was clearly intended to launch yet another of their many schemes for an international loan to Germany.\textsuperscript{4} However, this agenda was overshadowed by Poincaré’s speech calling for ‘productive pledges’ at Bar-le-Duc on 21 August;\textsuperscript{5} and by the remarkable response this elicited from Keynes in his address which concluded the Week on 26 August. Keynes’s reception in Hamburg was not unlike that bestowed on Richard Cobden when he had visited Hamburg in 1847. Introduced by Cuno as ‘the man most responsible for the changed attitude of the English-speaking world towards Germany’, he was cheered to the echo; and it is tempting to wonder how far the applause influenced the content of his speech. Having expressed the hope that ‘the day of scientific, administrative and executive skill is at hand … not this year, indeed, but next year’, Keynes made a fateful prediction:

I do not believe … France may actually carry into effect her threat of renewing war. … One or two years ago France might have acted thus with the necessary inner conviction. But not now. The confidence of the Frenchmen in the official reparations policy is utterly undermined. … They know in their hearts that it has no reality in it. For many reasons they are reluctant to admit the facts. \textit{But they are bluffing}. [my emphasis] They know perfectly well that illegal acts of violence on their part will isolate them morally and sentimentally, ruin their finances and bring them no advantage whatever. M. Poincaré … may make harsh speeches and inflict futile minor outrages … but he will not act on a big scale. Indeed, his speeches are an alternative not a prelude to action. The bigger he talks the less he will do. … The Germans will do well to keep cool and not be too much alarmed.\textsuperscript{6}

To cap this, he dismissed the idea that inflation was causing ‘the disintegration of German life’:

\textsuperscript{1} Ibid.
\textsuperscript{2} StAH, SK II III A 1 a 13, [programme] 17 Aug. 1922.
\textsuperscript{3} WA, XVII, Allgemeines 1922, Willy Sick to Warburg, 11 Oct. 1921 and subsequent correspondence; StAH, Firma A. O. Meyer 1, Bd. 12, 465, Witthoeft to Warburg, 17 May 1922. Cf. the material in StAH, SK II III A 1 a 13, Gesellschaft zur Förderung der Úberseewoche Hamburg.
\textsuperscript{4} WA, Allgemeines 1922, Melchior Memorandum, 5 Aug. 1922. Melchior now envisaged a three to five year ‘pause’ in reparations, along with a loan to be issued up to a maximum of 20 bn. GM.
\textsuperscript{5} Maier, \textit{Recasting Bourgeois Europe}, p. 284; \textit{Hamburger Fremdenblatt}, 26 Aug. 1922.
\textsuperscript{6} Keynes, \textit{Collected Writings}, xviii. 18–26.

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One must not lose sight of the other side of the balance sheet. ... The burden of internal debt is wiped off. The whole of Germany's payments to the Allies so far ... have been entirely discharged by the losses of foreign speculators. I do not believe that Germany has paid a penny for these items out of her own resources. The foreign speculators have paid the whole of these liabilities and more too.1

His conclusion amounted to an endorsement of the Hamburg proposals for a moratorium, a loan and a reduced reparations burden.2 In private, it is true, Keynes was rather less rash. In response to the French demand that the Reichsbank's reserve be used to guarantee future reparations payments, he commented: 'If the French actually have political plans (occupation of the Ruhr area ... etc.), then a concession would be worthless: the conflict would only come a few months later.' His advice on monetary policy likewise acknowledged the imminence of a liquidity crisis in Germany, as inflationary expectations began to outstrip the supply of banknotes.3 And he was clearly shocked by the impact of what was now hyperinflation on everyday life in Hamburg.4 But it was the public remarks which had the greatest impact; not least because he was telling the Germans what they wanted to hear. Poincaré's 'bluff' should be called: this was the message relayed to Wirth from Hamburg. The fact that Wirth promptly offered the Foreign Ministry to Melchior and then to Cuno indicates the importance attached to the Hamburg initiative.5

Keynes's prediction that 'the day of scientific, administrative and executive skill was at hand ... not this year, indeed, but next year' echoed a series of speeches which had been made in Hamburg by Warburg and his associates some months before, demanding that precedence by given to 'the men of business over the diplomats and politicians in all questions of world economics'.6 These calls were answered with the appointment of Cuno as Wirth's successor at the head of 'a Cabinet of Labour, composed according to the necessity for the objective management of business' – meaning, of course, a cabinet which would exclude the influence of organized labour.7 Keynes in England was enthusiastic. It would, he wrote, be 'a govt. a little more to the right than was Wirth's,

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1. Ibid.
2. Keynes suggested a total of 40 bn. GM to be paid in annuities of no more than 1 bn. GM before 1919. Cf. the reports of the American Consulate: NAW, RG 59, 862.607/44, Huddle to State Dept, 30 Aug. 1922; Walk to State Dept, 1. Sept. 1922. The significance of this speech is not appreciated by Keynes's biographers: see Harrod, Keynes, pp. 316, 325; Skidelsky, Economist as Saviour, p. 115.
3. WA, Allgemeines 1922, Melchior, Notiz, 28 Aug. 1922. Also present at this meeting, which was held at Cuno's house, were Cuno, Bergmann and State Secretary Schröder of the Finance Ministry.
and a little more under industrial influences’. 1 Eagerly, he urged the new Chancellor to ‘call ... out in a clear voice’, and confessed to ‘envy[ing] Cuno his job’. 2

It would, of course, be absurd to lay the blame for the Ruhr occupation and the final, irretrievable collapse of the German currency solely on John Maynard Keynes. 3 Clearly, many other factors lay behind Cuno’s appointment and the decision to adopt a course of confrontation with France. 4 But there is no question that Keynes played a hitherto-neglected role in encouraging both. Nor was he dismayed by the revelation that Poincaré had not, after all, been bluffing. Throughout the early weeks of the Ruhr occupation, he encouraged Germany to ‘hold out to the limit of her endurance’ and the government to ‘keep its nerve’. 5 The problem was that, under the economic pressure of sustaining passive resistance, ‘German endurance’ quickly reached its limits; while, as the Hapag agent Arndt von Holtzendorff and others who visited London discovered, official British opinion was still far less sympathetic than Keynes. 6 By May, with the French grip on the Ruhr showing no sign of weakening and the German economy plunging ever deeper into the hyperinflationary abyss, even Keynes was obliged to admit that some new diplomatic approach was required. 7 Cuno had already made one attempt to invoke British mediation, following an encouraging speech by the Foreign Secretary, Curzon, on 20 April. 8 However, despite Melchior’s efforts, the final draft of the note issued by the government made no significant advance on the previous German statements of January, and was dismissed out of hand by Poincaré. 9 Keynes felt he could do better. After consultations with the new Prime Minister, Baldwin, and Reginald McKenna (whom he wrongly expected

1. Keynes, Collected Writings, xviii. 64f.
4. Ibid., pp. 490–507.
8. WA 33, Pol. Corr. 1923, Melchior, Notes, 11 May 1923; Keynes, Collected Writings, xviii. 134–41; Skidelsky, Economist as Saviour, pp. 121–5; Bravo, ‘‘Keynes–Cuno Affair’’, 147–158, 163. In suggesting that this initiative ‘paved the way’ for the Dawes Plan, Skidelsky and Bravo exaggerate its significance.

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to be the next Chancellor), he travelled to Berlin; and, largely as a result of his influence, the new note made no mention of a total sum. Yet Keynes continued to underestimate the weakness of the German position:

Let Germany, instead of making moan about how badly she is being treated, insist rather on her capacity of indefinite resistance and even introduce a slight note of menace. Her present propaganda . . . produces the impression that she will break down before long. In the long run, firmness and a proud bearing will produce more effect on opinion than conciliations and moans.

Such fighting talk overlooked the fact that the impression of imminent collapse was not a tactical device, but a true representation of the German situation: ‘indefinite resistance’ was not a realistic option. Although the final draft, with its guarantees of state revenues and a mortgage on private property, went significantly further than the first note, it brought no immediate relief, since Curzon declined to reply and Poincaré refused to negotiate until passive resistance was suspended.

This is not the place to describe the domestic factors which led to Cuno’s fall on 12 August, nor the protracted process by which passive resistance was wound up. Suffice to say that Keynes’s own account in his Tract on Monetary Reform (published in December 1923) was a trifle harsh, given his intimate involvement with Cuno’s decision to confront Poincaré and wage passive resistance:

It is necessary to admit that Cuno’s failure to control incompetence at the Treasury and at the Reichsbank was bound to bring [his fall] about. During this catastrophic period, those responsible for the financial policy of Germany did not do a single wise thing, or show the least appreciation of what was happening.

In view of such comments, it is difficult to escape the conclusion that, in much of what Keynes subsequently wrote on the subject of the German inflation, he was being wise after the event – having been rather unwise during it. In the Tract, he implicitly contrasted the German post-war experience with the British:

Each process, inflation and deflation alike, has inflicted great injuries. Each has an effect in altering the distribution of wealth . . . , inflation in this respect being the worse of the two. [It] also has an effect in overstimulating . . . the

1. WA 33, Pol. Corr. 1923, Keynes to Cuno, 16 May 1923; Warburg to Holtzendorff, 17 May 1923; Melchior to Keynes, 22 May 1923; Keynes to Melchior, 24 May 1923; Holtzendorff to Warburg, 25 May 1923; Melchior to Keynes, 26 May 1923; Keynes to Melchior, 26 May 1923; Melchior to Keynes, 28 May 1923; Melchior Angabe, 4 June 1923; Warburg, Aufzeichnungen, p. 116; Keynes, Collected Writings, xviii. 143–90; Skidelsky, Economist as Saviour, pp. 126f.; Bravo, ‘Keynes–Cuno Affair’, 139ff.
production of wealth. ... It impoverish[es] ... the middle class, out of which most good things have sprung ... [and] destroys the psychological equilibrium which permits the perpetuance of unequal rewards.¹

In themselves, these were not new theoretical insights. He had, indeed, made similar points more forcefully in 1919, famously endorsing the view (which he attributed to Lenin) that 'the best way to destroy the Capitalist System was to debauch the currency':

By a continuing process of inflation, governments can confiscate, secretly and unobserved, an important part of the wealth of their citizens. By this method, they not only confiscate, but they confiscate arbitrarily; and, while the process impoverishes many, it actually enriches some. The sight of this arbitrary rearrangement of riches strikes not only at security, but at confidence in the equity of the existing distribution of wealth. Those to whom the system brings windfalls ... become 'profiteers', who are the object of the hatred of the bourgeoisie, whom the inflationism has impoverished, not less than of the proletariat. As the inflation proceeds ..., all permanent relations between debtors and creditors, which form the ultimate foundation of capitalism, become so utterly disordered as to be almost meaningless. ... There is no subtler, no surer means of overturning the existing basis of society. ... In Russia and Austria-Hungary this process has reached a point where for the purposes of foreign trade the currency is practically valueless. ... There the miseries of life and the disintegration of society are too notorious to require analysis; and these countries are already experiencing the actuality of what for the rest of Europe is still in the realm of prediction.²

A better summary of the social consequences of hyperinflation would be hard to find in the subsequent literature. Yet the counter-inflationary remedies Keynes urged in December 1923 – monetary restriction and a capital levy – had been conspicuously absent from his advice to the Germans prior to that time. Indeed, on a number of occasions, Keynes had congratulated the Germans on the large-scale expropriation of foreign wealth which had been brought about by the inflation. Ultimately, it seems, he could not resist judging the inflation a success in terms of economic diplomacy: 'The remarkable experience of Germany during this period [he wrote in June 1929] may have been necessary to convince the Allies as to the futility of their previous methods for extracting reparations and was perhaps an inevitable prelude to the Dawes Scheme.'³ As he put it in a revealing speech to his old friends in Hamburg in 1932: 'I have often been doubtful during the past years about the wisdom of what you call the Policy of Fulfilment. If I had been a German statesman or economist, I think that I should probably have opposed it.'⁴

¹. Ibid., pp. 3, 29.
². Id., Economic Consequences, pp. 220–33.
³. Id. 'The Economic Chaos of Europe', in Collected Writings, xi. 365. This view has recently been echoed by Holtfrerich, 'Die deutsche Inflation 1918 bis 1923 in internationaler Perspektive', p. 327.
⁴. Keynes, Collected Writings, xxi. 47f.
He had, of course, opposed ‘fulfilment’ in the literal sense of the word. From 1919 onwards, he had repeatedly encouraged German financial experts like Warburg and Melchior in their resistance to Allied demands. He had heard and echoed their arguments at Versailles, predicting currency depreciation, the dumping of German exports and the westward march of Bolshevism as consequences of the treaty. He had shared their dismay at the reparations total set in 1921, and predicted German default from the outset. Only in late 1922 did he begin to suspect that the Germans were exaggerating their fiscal difficulties in order to keep inflation going. But even this still inclined him to egg on his friends in Hamburg to adopt a more confrontational strategy. Only when this ended in the complete collapse of the currency – rather than the collapse of reparations – did Keynes begin to distance himself.

Keynes’s interest in German affairs after 1923 never equalled that of the inflation years. He took a sceptical view of the Dawes Plan, which ushered in a brief period of three or four years during which German capital imports (largely from the US) sufficed to finance a continued trade deficit and the payment of reparations. As he cynically summarized the transfer process in 1926: ‘The United States lends money to Germany, Germany transfers its equivalent to the Allies, the Allies pay it back to the U.S. government. Nothing really passes – no one is a penny the worse.’1 Certainly, this was nearer the mark than the predictions of more optimistic observers that the flow of lending to Germany would lead to growth, recovery and liquidation of the reparations debt.2 However, Keynes failed to note that the circular flow he described was not a sustainable process. Firstly, the economic and political consequences of reparations – whether of paying them or of trying to avoid paying them – tended inevitably to erode the confidence of private investors.3 Secondly, even in an imaginary world without inflations and slumps, it seems likely that lending to finance reparations would not have been sustainable, because of the tendency for the rising burden of debt service on such loans to outweigh their benefits. Interest payments accounted for some 5 bn. GM between 1924 and 1932, adding to, rather than relieving, the already heavy burden of reparations.4 Even without the international financial crisis of 1931, a German debt crisis would have been probable.

Only when the crisis came did Keynes turn his attention back to Germany; and even then only fleetingly. He showed no interest in the

3. This is the point stressed by Holtfrerich, Inflation, pp. 154 ff., and Kindleberger, Financial History, pp. 306 ff.
schemes for reflation being developed by German economists like W. S. Woytinsky to combat the acute slump which had begun in 1928. But he did accept an invitation to address his old friends at the Hamburg International Economic Society in January 1932. Ever ready with a pat economic remedy, Keynes took the opportunity to urge Germany to follow the British example and devalue the Reichsmark, arguing that it was 'an indubitable necessity' for the country 'to abandon gold in the following year'. At the same time, he suggested, Germany should accept 'a final [reparations] settlement ... in return for a very modest annual payment commencing, say, three years hence'. Quite apart from the discomfiture this caused the German Chancellor Brüning, whose aim was to end reparations for good by maintaining a rigorously deflationary monetary policy, this call must have caused some disquiet among his audience. For, as Keynes himself acknowledged, by far the strongest argument against devaluation was 'the fear, so natural in Germany, of another great inflation'. Keynes was, of course, right to argue that this fear was exaggerated. But after the traumatic experience of 1919–23, it was perhaps understandable. And perhaps it was also understandable that the Germans, this time, did not take Keynes's advice.

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