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BRITISH FINANCIAL AND ECONOMIC POLICY  
TOWARDS GERMANY, 1931-39.

Thesis for Ph.D. Examination,  
University of Kent at Canterbury, January 1986.

Neil Forbes



British Financial and Economic Policy towards Germany, 1931-39.

ABSTRACT

This thesis attempts to show the complexity and convoluted nature of Britain's financial and economic relations with Germany in the 1930s. A great variety of influences (often in competition with one another) acted upon policy formulation in Britain. This helped to create different, but seemingly equally valid, opinions as to what constituted the 'national interest'. This, in turn, tended to exacerbate the rivalry which existed between government officials. In particular, the Foreign Office showed extreme hostility to the attitude of the Governor of the Bank of England as the latter attempted to facilitate agreements between Britain and Germany. Such domestic constraints, combined with the economic pre-occupations of the period, prevented policy-makers from developing a clear picture of the nation's interests. A study of bank archives reveals that the extent of the influence of London banks in determining British official policy has been greatly exaggerated. In the face of competition from rival interests, the London banks could not secure any special consideration for their position under the Standstill Agreements from the Government. Thus while the formulation of policy, confronted with the problem of Nazi Germany, showed that political and economic considerations were linked, perhaps to a degree greater than ever before, the indiscriminate use of the term 'economic appeasement' to describe British policy tends to hinder rather than aid historical understanding.

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List of Some Leading Officials involved in Policy-Making  
towards Germany in the 1930s.

Treasury:

Sir Warren Fisher,	Permanent Under-Secretary and Head of the Home Civil Service, 1919-39.
Sir Richard Hopkins,	Controller of Finance and Supply Services, 1927-32, then Second Secretary.
Sir Frederick Leith-Ross,	Deputy to Hopkins until 1932, then Chief Economic Adviser to H.M. Government.
Sir Frederick Phillips,	Under-Secretary 1932-39, Head of Finance Divisions.
S.D. Waley,	Principal Assistant Secretary, Overseas Finance.

Foreign Office:

Sir Robert Vansittart,	Permanent Under-Secretary, 1930-38, then Chief Diplomatic Adviser to H.M. Government.
Sir Orme Sargent,	Head of Central Department, 1928-33; Assistant Under-Secretary, 1933-39; Deputy Under-Secretary, 1939-46; Permanent Under-Secretary, 1946-49.
R. Wigram,	Head of Central Department, 1934-36.
F. Ashton-Gwatkin,	Head of Economic Section, 1933-40; Assistant Under-Secretary, 1940-47.

British Embassy in Berlin:

E. Rowe-Dutton,	Financial Adviser, 1929-33.
G. Pinsent,	Financial Adviser, 1933-39.
J. Thelwall,	Commercial Counsellor, 1928-37.
J.H. Magowan,	Commercial Counsellor, 1937-39.

Bank of England:

C.F. Cobbold,	Acting Deputy Chief, Overseas & Foreign Department, 1933-35; Adviser to the Governors, 1935-38; Director, 1938-45; Deputy Governor, 1945-49; Governor, 1949-61.
Sir Otto Niemeyer,	Adviser to the Governors, 1935-38; Director, 1938-52.
H.A. Siepmann,	Adviser to the Governors, 1926-45; Director, 1945-54.
Sir Henry Clay,	Adviser to the Governors, 1933-44.
C.A. Gunston,	Assistant Chief of the Overseas & Foreign Department, 1937-39; Assistant Adviser, 1939.

Leading Officials cont'd.

## City:

J.W. Beaumont Pease,	Chairman of Lloyds Bank Ltd. Chairman of Joint Committee of British Short-Term Creditors.
E.H. Lever,	Prudential Assurance Co. Chairman of Council of British Long-Term and Medium -Term Creditors of Germany; member of Joint Committee.
R.H. Brand,	Partner of Lazard Bros. & Co. Ltd. Member of Joint Committee; British Representative on Joint Committee of Foreign Bankers' Committees of Germany.
F.C. Tiarks,	Partner of J. Henry Schröder & Co. Member of Joint Committee; Chairman of Joint Committee of Representatives of Foreign Bankers' Committees of Germany.

Abbreviations used in Text and Footnotes

IDAC	-	Import Duties Advisory Committee
BIS	-	Bank for International Settlements
CID	-	Committee of Imperial Defence
FBI	-	Federation of British Industries
RGI	-	Reichsgruppe Industrie
Joint Committee	-	Joint Committee of British Short-Term Creditors

Abbreviations used in Footnotes  
(Full details given in Bibliography).

SDW	-	S.D. Waley
FLR	-	Sir Frederick Leith-Ross
RV	-	Sir Robert Vansittart
Parl. Deb. (H. of C.)	-	Parliamentary Debates, House of Commons
Cmd	-	Parliamentary Papers
DGFP	-	Documents on German Foreign Policy
DBFP	-	Documents on British Foreign Policy
CAB	-	Cabinet Files
FO, FO 800	-	Foreign Office Files
T 160, T 172, T 177, T 188	-	Treasury Files

Chapter 1  
Introduction

This study is concerned with the formulation and execution, by the British Government and quasi-governmental institutions, of financial and economic policy towards Germany in the period from Britain's departure from the Gold Standard in 1931 to the outbreak of the Second World War in 1939. By concentrating on this aspect of Britain's relations with Germany it is to be hoped that additional interpretations will be provided to questions concerning the interaction between British policy and the origins of the Second World War.

The thesis on which the work is based may be stated briefly as follows. Britain's financial and economic relations with Germany were complex and convoluted. There was, consequently, a great variety of influences (often in competition with one another) acting upon policy formulation. This helped to create different, but seemingly equally valid, opinions as to what constituted the 'national interest', which in turn tended to exacerbate the rivalry which existed between government officials. These domestic constraints, combined with the economic preoccupations of the period, prevented policy-makers from developing a clear picture of the nation's interests, assuming such a thing were possible. Thus while the formulation of policy, confronted with the problem of Nazi Germany, showed that political and economic considerations were linked, perhaps to a degree greater than ever before, the indiscriminate use of terms such as 'economic appeasement' to describe British policy tends to hinder rather than aid historical understanding.

The study of how financial and economic policy was made, how it was executed, and what it achieved should, therefore, throw more light on how the international developments of the 1930s affected the policy-making process in Britain. Yet such an approach to Britain's relations with Germany has not, until recently, appeared to fit too comfortably into historical writing of either the political or economic kind. This may be illustrated by reference to a few significant studies of the interwar period. In the emotive debate on the policy of appeasement the National Government and its advisers has been more frequently condemned than exonerated. Paul Einzig, a contemporary critic of government financial and economic policy in his articles in the financial press and many books, was the first to attempt to show a consistency of purpose which he believed ran through apparently isolated individual acts of economic appeasement. Einzig held the City of London in general, and Montagu Norman (Governor of the Bank of England) in particular, responsible for a disastrous economic policy towards Germany.<sup>1</sup>

In a work which follows broadly in the tradition of condemnation, Martin Gilbert's The Roots of Appeasement, the importance attached to economic considerations is clearly indicated. It is claimed that the most serious efforts at appeasement, unbeknown to the general public, were in the world of economics and trade, and that economic appeasement reached its apogee in 1937. But, apart from pointing to various schemes and ideas embraced by British officials, the substance of policy in this area is left untouched by Gilbert.<sup>2</sup>

One of the criticisms levelled at Gilbert's study concerned his analysis of the British Foreign Office. In particular, W.N. Medlicott could not agree with the conclusion that there was little enthusiasm among officials in 1935-6 for attempts at agreement with Germany. Rather, it was a question of how approaches were to be made. The Foreign Office, in the person of its Permanent Under-Secretary, Sir Robert Vansittart, was shown by Medlicott to be particularly disapproving of the activities of the Bank of England and the Treasury in negotiations with Germany.<sup>3</sup>

The frustration felt by the Foreign Office was clear as early as 1934. In a Cabinet Memorandum entitled, 'The Future of Germany', Vansittart characteristically sounded the alarm: Germany was rearming by means of fraudulent bankruptcy. Autarky, begun under Brüning and therefore no new invention, was to make Germany less vulnerable in the next war. Most significant of all, in Vansittart's opinion, "The City - whose policy in respect of Germany has been a mill-stone round the neck of this country - believes the Foreign Office is anti-German."<sup>4</sup>

1.P. Einzig, Appeasement Before, During and After the War (1942). Einzig certainly enjoyed a network of information and was uncannily gifted in technical matters of the foreign exchanges. But his somewhat inflated works are marred by egotism and self-importance. Einzig gave the impression that he fulfilled in the City the role which Churchill occupied in Parliament. In his auto-biographical work In the Centre of Things (1960), p.177, Einzig wrote, "Mine was a lone voice crying in the wilderness".

2. M. Gilbert, The Roots of Appeasement (1967), p.151.

3. W.N. Medlicott, Britain and Germany: The Search for Agreement 1930-37 (1969).

4. CAB 24/248(104), App.34.



In the 1930s the term 'autarky' came into common usage to describe a contemporary trend in trade policy, namely, the drive of a state to ensure self-sufficiency. Some commentators substituted, perhaps not always consciously, the word autarchy for autarky, or the power to control one's own destiny. Indeed, it was thought that autarchy was the basic idea underlying German trade policy, particularly in regard to S.E. Europe. Attempts were made to form commercial links so close that the countries of the region would find it impossible to divert exports to alternative markets.<sup>5</sup>

The extent of the influence of the financial institutions of the City has been examined, among other things, in the innovative work by Bernd-Jürgen Wendt, Economic Appeasement.<sup>6</sup> In the 1930s the term 'appeasement' was used to indicate any international negotiation to relieve tension. By the end of the decade the term had suffered a degradation of meaning: appeasement represented a policy of simple piecemeal surrender to the dictators in a futile attempt to ensure peace. Wendt's overall intention was to release the term from a narrow political meaning and to show how no clear line could be drawn between political and economic appeasement.

In one fundamental respect Wendt's study remains controversial. His thesis is that the supporters of Anglo-German trade and finance continually exercised a considerable influence on the planning and execution of policy. The capitalist institutions of the City were looking for the re-establishment of political and financial trust as a basis for the revival of international trade activity and world prosperity. Many in Britain regarded National Socialist Germany, first and foremost, as belonging to the capitalist system of western Europe. It was hoped, therefore, that a natural congruity of business interests would bridge political differences. So as long as the Third Reich wished to continue profitable trading and to remain a credit partner, interested circles were willing to overlook the repulsive and criminal practices of Nazism as an internal German affair.<sup>7</sup> Certainly many held the view

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5. See A.G.B. Fisher, Economic Self-Sufficiency (Oxford 1939).

6. B.J. Wendt, Economic Appeasement: Handel und Finanz in der britischen Deutschland-Politik 1933-1939 (Düsseldorf, 1971).

7. *ibid.* p.17. B.J. Wendt, "'Economic Appeasement' - A Crisis Strategy", in W.J. Mommsen and L. Kettenacker, eds. The Fascist Challenge and the Policy of Appeasement (1983).

(when, for example, the Rhineland was reoccupied in 1936), that what the Nazis did in their own backyard was their own business. But more than this, Wendt claims that this fusion of political-business interests between the City (especially the bankers), and the conservative-bourgeois Government was a step away from being a "conspiracy".<sup>8</sup>

In England in der Krise Gustav Schmidt has attempted a comprehensive treatment of the subject of appeasement in both its political and economic forms. Schmidt claims that Wendt's conclusions are questionable because, although he bases his work on wide ranging source material, he does not show either the degree to which articulations of the varied financial and economic interests were allowed to filter through the Cabinet Committee system to influence the decision-making process, or the grounds on which the Government took decisions in favour of 'pro-German' economic interests.<sup>9</sup> Thus the point is made that it is necessary to acquire a firm basis for assessing the continuity of influence enjoyed by different vested interests if political strategies like appeasement are to be fully understood. Indeed, recent studies have indicated that interpretations of British foreign policy in the 1930s will not be complete until the nexus of political, social and economic factors which helped to determine government policy is clearly established.<sup>10</sup>

As far as the interwar period is concerned, the subjects of towering importance, such as the Depression, Protectionism, and the question of economic recovery, continue to demand the attention of economic historians. It is, of course, important to understand the relationship between domestic economic structural change and changing world conditions. But, as yet, little light has been thrown on the problems of interpreting British policy towards Germany. Descriptions of the interests of industry or an individual company in and towards such a vital market as Germany are, for example, rather limited. Economic historiography does, however, provide a frame-work for an analysis of the financial and economic connection between Britain and Germany.

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8. Wendt, Economic Appeasement, p.142.

9. G. Schmidt, England in der Krise: Grundzüge und Grundlagen der britischen Appeasement-Politik (1930-1937) (Wiesbaden, 1981), p.29, n.19.

10. D.C. Watt, 'The European Civil War', in Mommsen and Kettenacker, The Fascist Challenge.

i) The Anglo-German Financial and Economic Relationship.

The financial and economic relationship between the two countries must, of course, be viewed in the context of the major economic developments of the interwar years. Anglo-German trade, for example, was not immune to the general trends of the period. Apart from its deep psychological effects the First World War initiated an era of significant economic change. The delicate machinery of international economic and financial co-operation was disrupted and never really recovered. The system of multilateral trade and payments and the free flow of capital, labour and commodities was to break down under the rise of nationalistic economic policies and managed currencies.<sup>11</sup>

According to W. Arthur Lewis the 1920s were never felt to be a new era in Europe. And the Depression of the 1930s was taken as evidence that the tasks of the preceding decade had not been achieved. International investment was moving to Europe from America instead of following the reverse movement of prewar days and to the uneasiness about this was added a sense of insecurity in important countries like Britain and Germany which had not re-found their place in the world economy.<sup>12</sup>

Before 1914 Germany had rivalled Britain as world export leader. Recovering in the 1920s Germany ranked, for the first time, second to the USA from 1930-32. The U.K. regained second place in 1933 and maintained it. But by the middle of the decade Germany was tending to improve her relative position. <sup>13</sup> The National Government in Britain brought in the Abnormal Importations Act and Horticultural Products Act in November 1931 to stem the flood of imports by imposing a wide range of duties, except on goods from the Dominions and colonies. By early 1932 a general tariff of 10 per cent ad valorem was introduced, on top of which the Treasury was empowered to impose further tariffs on the recommendation of the Import Duties Advisory Committee. In practice this led to a tariff of 20 per cent or more on most manufactured imports. Later in 1932 the Ottawa Conference resulted in a series of bilateral agreements in which the U.K. and individual Dominions swapped mutual preferences (which mostly meant maintaining or erecting trade barriers against foreign goods), with the desired result that trade was diverted to the Empire.

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11. See D.H. Aldcroft, The European Economy 1914-1970 (1978).

12. W.A. Lewis, Economic Survey 1919-1939 (1949), p 138.

13. T 160 729 12829/2.

In December 1931 deflation was attempted in Germany. But with the pound losing 30 per cent of its value after Britain left the Gold Standard, a 10 per cent devaluation of the Reichsmark could not be expected to achieve much in the field of international competition. (See chapter III). While British exports fell in 1932 (although her share of world exports jumped upwards), German exports continued to fall to 1934 when they were a mere 50 per cent of their 1929 value, compared with the U.K. figure of 70 per cent.<sup>14</sup> The advantage Britain gained from depreciation was exhausted well within two years. Yet up to 1935 British exports outstripped the growth in world trade.<sup>15</sup> In spite of a great outcry in foreign countries against the German 'trade drive', the quantity of German exports in 1937 was only at 69 per cent of its 1929 level, while the British figure was 83 per cent.<sup>16</sup>

Indeed, it has been estimated that although German exports declined in value by 17 per cent and imports by seven per cent in the recession of 1937-8, the corresponding figures for Britain were 11 and 15 per cent respectively. While rearmament brought ever increasing intensity of activity in the German domestic market, the recession in Britain caused more attention to be paid to the export markets and price cuts might have been accepted more readily.<sup>17</sup>

In terms of gold, however, the value of British and German exports declined just about equally from 1929-37; as German prices had not declined so much, Germany obtained more for her exports. It is, however, particularly difficult to establish a reliable index for German prices. Allowance has to be made for special kinds of marks below official parity and for the sale of goods at less than the cost of production by means of export subsidies. Nevertheless, it has been calculated that export prices remained up to 20 per cent higher than British prices. This was one reason for the decline in the German share of world exports.<sup>18</sup>

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14. W.A. Lewis, Economic Survey, p.92.

15. D.H. Aldcroft, The Inter-War Economy: Britain, 1919-1939 (1970), p.281-2.

16. Lewis, Economic Survey, p.92.

17. C.W. Guillebaud, The Economic Recovery of Germany from 1933 to the incorporation of Austria in March 1938 (1939), p.148.

18. H.S. Ellis, Exchange Control in Central Europe (Cambridge, Mass. 1941), p.239.

The economic relationship between the two countries themselves was not insignificant. Both countries took a large share of the other's exports, with the trade balance lying in Germany's favour. Along with the Netherlands Britain was, until 1932, by far the most important export market for Germany. The commodities traded covered a wide range of manufactured and finished goods, especially machinery, and also chemical products such as dyestuffs. Indeed, the Dyestuffs Act of 1920, which placed import duties on a wide range of chemicals, was an attempt to shut out German competition from the British market.<sup>19</sup> And for British exports, especially for those of coal, herrings and textiles, Germany was also an important market.

Table 1

A Comparison of Sources and Destinations for British Imports and Exports.<sup>20</sup>

			Average %		
Rank			1904-13	1920-9	1930-8
Germany	Imports	5= with France	9.39	3.77	4.57
	Exports		8.74	4.61	4.24
	Exports & Re-exports	5	10.36	6.63	5.7
U.S.A.	Imports	1	19.55	19.99	11.96
	Exports		6.73	6.79	5.06
	Exports & Re-exports	2= with Australia	10.78	8.62	6.05
India	Imports	2	6.41	5.27	5.44
	Exports		12.28	12.28	8.57
	Exports & Re-exports	1	10.28	10.68	7.65

19. See W.J. Reader, Imperial Chemical Industries: A History, II, (1957), P.239. F. Capie, Depression and Protectionism: Britain between the Wars (1983), p.40.

20. Taken from F. Capie, Depression and Protectionism, p.19.

Table 2  
Anglo-German Trade 1929 - 1938 in £ million. 21

<u>Year</u>	<u>British Exports to Germany</u>		<u>British Imports</u> <u>from Germany</u>	<u>Balance to</u> <u>Germany</u>
		(re-exports)		
1929	60.2	(23.3)	68.8	8.6
1930	44.1	(17.3)	65.5	21.4
1931	32.0	(13.6)	64.2	32.2
1932	25.4	(10.8)	30.5	5.1
1933	24.6	( 9.8)	29.8	5.2
1934	22.9	( 8.9)	30.6	7.7
1935	28.1	( 7.8)	31.8	3.7
1936	27.9	( 7.4)	35.3	7.4
1937	31.4	( 8.0)	38.8	7.4
1938	28.5	( 6.6)	31.9	3.4

The table above gives a dramatic indication of the combined effects of the depreciation of sterling, the imposition of tariffs and the trade depression on Germany's exports to Britain. French exports to Britain suffered a similar decline. Indeed, it was not a matter of surprise that British policy was far from popular, even though Germany herself had imposed an average ad valorem 15 per cent duty on all imports as early as 1925. It also encouraged many in Germany to attribute to the lack of an Empire, both as a source of raw materials and as a market for exports, all their political and economic ills.

In February 1932, for example, German cotton spinners complained of the advantage which the devaluation of sterling had secured for British exporters in the German market. In the same month a drastic reduction took place in the admission of British coal to the German market, the monthly quota for which declined from 420,000 tons in September 1931 to 100,000 tons.<sup>22</sup> In the generation of Britain's national income foreign trade became progressively less important, and the loss of overseas markets for staple goods left those industries concerned massively depressed. Yet, as late as 1937, coal accounted for 8 per cent of British exports.<sup>23</sup> For this reason, British negotiations with Germany over coal exports played an important part in the relationship until the eve of the Second World War.

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21. U.K. Customs and Excise Department, Annual Statement of The Trade of the United Kingdom 1932, IV (1934), 1935, IV (1937), 1939, IV (1941).

22. League of Nations, British External Economic Policies (Paris, 1939).

23. B.W.E. Alford, Depression and Recovery? British Economic Growth 1918-1939 (1972), p.58.

The financial relationship between Germany and Britain in the interwar years was not the usual one between debtor and creditor nation. The international payments made by Germany were dominated by Reparations (until 1932), and by the Dawes and Young Loans. These two loans were guaranteed by the governments of the participating states, but it was the public and the financial institutions which subscribed to them. When the National Socialists gained power in Germany they sought to equate any payment made abroad with one form of tribute or another, and they continually attempted to reduce the service of Germany's international debts.

Many of the financial commitments which bound Britain and Germany together were entered into in the 1920s. British capital, in the shape of several different kinds of loans from various sources, formed a significant part of Germany's external debt. Indeed, British creditors became entangled in a complex pattern of loans to German borrowers. The most important loans - in terms of volume and function - were the short-term credits made to German banks, industry and commerce by British banks, acceptance and discount houses for the purpose, in theory, of financing trade.

Acceptance credits were advanced by means of bills of exchange. These were self-liquidating only if documents were attached giving title to the goods. But as bills of this kind were somewhat clumsy to negotiate, the City had for generations financed drawers of good standing all over the world by means of non-documentary credits. From 1920-29, about one half of the acceptances were finance bills which did not arise from goods transactions but were used to extend credit to Germany and other central and eastern European countries.<sup>24</sup> This proportion was probably even greater for the United States' banks, many of whom had only set up in this kind of business after 1918. The German banks reloaned the money to German industry and municipalities on long-term account. The monetary system was thereby overhauled, working capital replenished, and German industry was developed and rationalised in the hope that exports would be increased. However, some of the loans were used for the improvement of public amenities and even for speculation.

Thus it would seem to be the case that British banks were less liquid than they had been and that they were less exacting in their credit standards. The acceptance houses in particular greatly increased the ratio of revolving acceptances to capital. London even extended credits without regard to the protests of the Reichsbank and German Government. The British banks were accused of desiring excessive profits. Critics pointed out that British financiers had been borrowing from the French and Americans at 2 per cent and lending to the



Germans at 8 per cent. It was even suggested that this policy was a cause of the financial crisis. Since the run on sterling followed immediately upon the German bankruptcies, it appeared that continental holders of sterling claims, being familiar with British commitments in Berlin, were motivated by knowledge of the weakness of the latter.<sup>25</sup>

Nevertheless, the City believed that it had done nothing more than carry on its normal business; it could not insure against panic withdrawal by foreign creditors. One leading banker, R.H. Brand, wrote to The Times in 1935 to say that the amount of short-term money outstanding to Germany in 1931 (£64 million), was probably considerably smaller (how much smaller was not said), than the amount London was lending in 1914.<sup>26</sup>

Table 3  
German Short-Term Debts at 30 September 1932 in RM million. 27

<u>Creditors</u>	<u>Debtors</u>					Total
	Banks	Reichsbank & Golddiskontbank	Industrial etc.	Municipal	Other	
Banks	3,342	814	1,656	535	95	6,442
Finance Houses	118		355	4	47	524
Companies	109		1,405	2	47	1,563
Others	292		329	81	116	818
Total	3,861	814	3,745	622	305	9,347
<u>Creditor Country</u>						
U.S.A.	1,592	190	640	443	33	2,898
U.K.	661		423	62	25	1,171
Switzerland	613		859	55	84	1,611
Holland	373		1,081	27	78	1,559
France	239		134	18	8	399

24. W.A. Morton, British Finance, 1930-1940 (Madison, 1943), p.270.

25. *ibid.* pp.30-3.

26. C.R.S. Harris, Germany's Foreign Indebtedness (1935), p.23. These points are considered in more detail in Chapter II.

27. *ibid.* p.21.



ii) The Foundation of British Policy Towards Germany.

After 1931 international investment ceased, capital repayment to the creditor countries exceeded new loans and relations between debtors and creditors became very strained. Such changing conditions in the world economic order were, of course, an important influence on policy-making in Britain. Furthermore, the long-term trend of a decline in British economic resources in comparison to her major international competitors was quite evident, as was the fact that because of her dependence on overseas trade Britain also relied, more than any other power, on preservation of stability in international affairs. It has been pointed out how the National Government was continually pre-occupied with the thinness of the veneer of British prosperity: advocates of rearmament were always opposed by arguments about the need for stability, in order to preserve Britain's economic position.<sup>28</sup>

The National Government was itself formed in economic crisis. Whatever disagreements arose in Cabinet, and whatever the nature of opposition in or outside Parliament, unity between ministers remained of paramount importance. Resignations, like that of Anthony Eden in February 1938, are remarkable in that they represent the rare cases of dissent. The National Liberals, Sir John Simon and Walter Runciman, appear to have been in complete harmony with their Conservative colleagues, apart from the agreement to differ, and to let that be known outside the Cabinet, over the imposition of Protection in 1932.

To add to this, it is possible that features inherent in the culture of British politics, such as prudence, pragmatism and moderation, made it difficult for politicians to understand the new totalitarian ideologies. Paul Kennedy has argued that as little had changed in the British modus procedendi since far back into the nineteenth century, politicians were ill-equipped to appreciate the extent of political change in other countries.<sup>29</sup>

In general, economic management by government in the interwar period in Britain may be characterized as turning from a passive to an active policy, or from non-intervention to intervention. Even at a date as advanced as 1936, J. Henry Richardson believed that the need for, and the limitations of, the co-ordination of economic with political policy had been discerned only in part.

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28. See K. Middlemass, Diplomacy of Illusion: The British Government and Germany, 1937-39 (1972), p.12.

29. P. Kennedy, The Realities Behind Diplomacy (1981), p.255.

Inconsistencies were frequent and harmony accidental.<sup>30</sup> The Depression brought about a fundamental change not because economic changes resulted directly or a radical reassessment of economic policy was brought about, but because new policies were implemented either on grounds of expediency or because short-term conditions forced them on a reluctant government.<sup>31</sup>

Indeed, the role of economic doctrine in policy formulation should not be over-emphasised; policy was often dictated not by official understanding of economic principles but by public attitudes. It is also the case that new economic ideas made little headway in the Treasury. The Chancellor, Neville Chamberlain, and Treasury officials shared certain fixed principles: the need to avoid risks, governmental retrenchment, and an almost Gladstonian desire to reduce the public debt. It would seem that the influence of Keynes on Treasury policy formulation was very limited before the Second World War.<sup>32</sup> It was the growing need for rearmament from the mid 1930s, rather than the implementation of Keynesian ideas, which forced the Government to abandon the orthodoxy of balanced budgets. The stimulus thereby given to the economy and consequent drop in unemployment was, ironically, provided by the one type of government expenditure which the Labour Party would not advocate for ideological reasons.

In spite of these qualifications it is possible to say that the 1930s witnessed a revolution in British economic policy. The 1931 crisis gave the ~~Conservatives~~ an opportunity to bring in Protection, which they had been prevented from doing by their election defeat in 1923. In contrast to the United States the most decisive change in policy and the most significant attempt by government to aid domestic recovery belonged to the sphere of foreign economic policy, so far as it is realistic to make a distinction between the two spheres.<sup>33</sup> Economic policy therefore provided a permanent, almost unchangeable, element in the making of foreign policy.

In introducing Protection Chamberlain told the House of Commons, "We mean also to use it for negotiations with foreign countries which have not hitherto paid very much attention to our suggestions".<sup>34</sup> Protection and Imperial Preference

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30. J.H. Richardson, British Economic Foreign Policy (1936).

31. H.W. Richardson, 'The Economic Significance of the Depression in Britain', Journal of Contemporary History, 4 (1969).

32. C.P. Kindleberger, The World in Depression, 1929-1939 (1973), p.24.

R. Middleton, Towards the Managed Economy (1985), p.31-7; also 'Fiscal Policy and Economic Management in 'the 1930s' (unpublished Ph.D. thesis, Cambridge University, 1981), p.265. E.W. Bennett, German Rearmanent and the West, 1932-1933 (Princeton, 1979), p.121. G.C. Peden, 'Sir Richard Hopkins and the "Keynesian Revolution" in Employment Policy, 1929-45', Economic History Review,

were thought of as temporary expedients. Yet the trauma of the financial crisis, the political disorientation of the following years, and the constraints of the Ottawa Agreements all combined to frustrate any ideas of breaking down tariff barriers. The 1938 Anglo-American Trade Agreement, although a significant development in trade liberalisation, confirmed the difficulties created by preference policies.

The problems of economics which acquired, for the first time, such an importance after the First World War, therefore placed new demands on government for economic management. How then did policy formulation and attitudes towards Germany respond in this respect? If it is accepted that British foreign policy in the early 1930s exhibited traditional tendencies of leaving the evolution of policy dependent on developments in Europe, was there a failure to define aims and pursue policies in regard to Germany?

Reparations and war debts are the two most obvious examples of how economic matters dominated international relations after 1918. Pertinent to this study is consideration of how the war and its aftermath was seen to have affected Anglo-German economic relations. The propaganda composed by Keynes, for example, had a considerable effect on contemporaries. Keynes claimed that Sir Eric Geddes provided the "grossest spectacle" in demanding that the lemon should be squeezed till the pips squeaked. Before the war international trade, of which Anglo-German trade was of such importance, worked with almost perfect simplicity. And it was through trade-generated prosperity, Keynes argued, that international co-operation could once again be achieved, as well as aiding Britain's recovery.<sup>35</sup>

Indeed, a Board of Trade White Paper of 1919 suggested that it was not part of Government policy to discourage British traders from competing in and securing a proper footing in the developing markets of the late enemy countries which had become open to the whole world.<sup>36</sup>

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32...contd. Vol. XXXVI, No. 2, May 1983.

33. H.W. Arndt, The Economic Lessons of the Nineteen Thirties (1944), p.94.

34. Parl. Deb. (H. of C.) Vol. 261, 4 Feb. 1931, col. 287.

35. J.M. Keynes, The Economic Consequences of The Peace (1920), p.131.

36. Richardson, British Economic Foreign Policy, p.19.

When the Nazis came to power in 1933 the seemingly admirable and sensible desire to help in the economic recovery of Europe, especially Germany, (which had marked the period up to 1931), no longer had universal appeal. Some in Britain believed that the way to prevent the 'extremists' from gaining the upperhand over the 'moderates' in the Nazi régime was to facilitate German prosperity; others believed that German prosperity would only facilitate German rearmament and thereby endanger the peace of Europe. The debate over whether to strengthen the German economy by trade was at its keenest where strategic raw materials such as oil were concerned. (See Chapter VI). An analysis of the assumptions made by government and influential interest groups concerning the nature of the Nazi régime thus plays an important part in understanding the basis of British economic policy towards Germany.

Of all the arrangements constructed in the 1930s the Anglo-German Payments Agreement of 1934 represented the foundation stone for much of British policy towards Germany. (For the origins of the Agreement see Chapter V). Throughout the rest of the decade British officials were most concerned that the agreement should endure. It was felt that, driving a hard bargain, the U.K. had achieved a settlement more favourable than any other country in Europe. The agreement, the administration of which fell to Germany, allowed Britain, alone of creditor countries, to accomplish substantial liquidation of its old commercial claims.<sup>37</sup> Britain was willing to allow Germany a favourable trade balance in order to facilitate debt repayment of all kinds. But pledges were secured for the continued purchase by Germany of specific British exports such as textiles. German freedom to alter the terms of trade by means of her comprehensive system of subsidy and licensing was thereby limited, the more so as subsidies for exports to Britain were probably already extensive because of sterling's depreciation. In negotiating the Agreement the U.K. was placed in a strong bargaining position because officials acted as if the country could afford to turn to other export markets (which was doubtful). More importantly, the U.K. was a relatively expensive but unavoidable source of important raw materials.

For this reason, the Payments Agreement was criticised at the time of its operation and subsequently. Writing in 1943 H.D. Henderson was of the opinion that it was after the prospects of war had become so menacing that only the most wishfully minded could seriously hope for the maintenance of peace, that Germany and Japan imported raw materials which they laid by as a war reserve.

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37. Morton, British Finance, p.178.

The claim was also made that it seemed impossible to interfere with this traffic, the significance of which was unmistakable, because this would have offended against those principles of the liberal commercial code which still inspired respect. Henderson concluded that there was better reason for holding that the remains of economic liberalism helped the Axis Powers to make war than that economic nationalism provoked them to it.<sup>38</sup>

The role of the Civil Service in the making of policy such as the Payments Agreement can scarcely be over-estimated: the corporate influence of the administrative class in Britain has probably never been greater than in the 1930s. One reason for their importance was that their numbers were relatively small. The sphere of government in the legalistic, bureaucratic sense was much smaller than the modern equivalent. Yet governmental activity had been growing since the First World War when the Ministry of Munitions had set the pace, with the Treasury, Board of Trade, and the Bank of England becoming increasingly involved in domestic industry. This trend continued after 1931 to the extent that large interest groups (employers' organisations and trades unions), accepted the need for formal collaboration with the state in order that some kind of balance might be struck. Although this did not amount to a formal corporatist structure, there was a tendency for different sectors in society to band together to face an increasingly hostile world.<sup>39</sup>

The change from government by parliamentarians to government dominated by an economically oriented bureaucracy went forward very slowly. Government as a whole was also lacking in co-ordination: the rise of the inter-departmental committee was in its infancy.<sup>40</sup> It was not until 1940, for example, that official statistics of National Income and Expenditure were first compiled.<sup>41</sup>

The Treasury, especially, occupied a key position, firstly because of the perennial importance attached to financial matters, and secondly because the offices of the Permanent Head of the Home Civil Service and Permanent Under-Secretary of the Treasury were combined in the person of Sir Warren Fisher. He was not successful, however, in also bringing the Foreign Office within the realm of his jurisdiction. The Second Secretary at the Treasury was Sir Richard Hopkins who, as the leading expert on fiscal matters and the principal link with the Bank of England, probably exercised a degree of influence similar to that of a Cabinet minister.<sup>42</sup>

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38. H.D. Henderson, The Inter-War Years and Other Papers (Oxford, 1955), p.290.

39. See K. Middlemass, Politics in Industrial Society (1979).

40. J.S. Eyers, 'Government Direction of Overseas Trade Policy in Britain, 1932-37' (unpublished D. Phil. thesis, Oxford University, 1977), p.242.

The same was true of Sir Frederick Leith-Ross. In 1932 Leith-Ross was transferred from his post of deputy to Hopkins to become Chief Economic Adviser to the Government. Leith-Ross had an office in the Board of Trade, but it was through the Treasury that he mainly worked. He was occupied with an aspect of Treasury work which had developed after 1918: economic relations with foreign governments and financial institutions. Leith-Ross therefore played a crucial role in determining policy towards Germany. He maintained in his autobiography that he disagreed with those who thought that political difficulties could be solved by removing economic thorns from the flesh. He believed rather that politics in international affairs governed actions at the expense of economics, and often of reason.<sup>43</sup>

If the Treasury was not completely converted to the 'new economics' by the time of the Second World War, Peden has suggested that it should not be surprising that the significance of such ideas was not grasped, as economists themselves disagreed fundamentally with one another.<sup>44</sup> Moreover, the suspicion was entertained that economists were not practical enough. Yet such distrust extended to experts of all kinds, with the exception of the financial experts in the Treasury and the Bank of England, with the former continuing to regard the latter as the best judge of the possible effects of proposed policies on business confidence. The relationship between the two institutions was reinforced by the fact that Sir Otto Niemeyer and H.A. Siepmann had joined the Bank after outstanding careers in the Treasury in the 1920s.<sup>45</sup> The Treasury was compelled to respond to a variety of pressures, which included Parliamentary opinion, the City, industrial interests, the reconciliation of conflicting departmental interests, as well as the strictly economic needs of the time. This made the Treasury cautious in outlook.<sup>46</sup>

Such was the quarrelling between government departments over proposals put forward by the Deputy Under-Secretary at the Foreign Office, Sir Victor Wellesley, that when the Commercial Diplomatic Service and Department of Overseas Trade were created, they were put under the joint control of the Board of Trade and Foreign Office. The new service was designed only to assist the effort to get new export markets for British goods; it failed to give recognition to the more vital need to integrate trade and finance and diplomacy. Yet conditions soon turned the new commercial ambassadors into the economic advisers of the diplomatic posts to which they were attached.<sup>47</sup>

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41. G.C. Peden, British Rearmament and the Treasury: 1932-1939 (Edinburgh, 1979), p. 61. The statistics were published in 1941.

42. See D.C. Watt, Personalities and Policies: Studies in the Formulation of British Foreign Policy in the Twentieth Century (1965). Also M. Beloff, 'The Whitehall Factor: The Role of the Higher Civil Servant 1918-1939', in G. Peele and C. Cook, eds. The Politics of Reappraisal, 1918-1939 (1975).



Wellesley also urged, in the face of indifference in the Foreign Office and hostility elsewhere, the necessity of creating an Economic Intelligence department to liaise with the Treasury and Board of Trade and to advise on long-term policy. There was, of course, a danger that such an exercise would be self-defeating. A highly specialised economics department might simply have duplicated work done in the Treasury while not having time to be expert in the Foreign Office's own main concerns. Eventually the Foreign Office's Economic Relations Section, under Ashton-Gwatkin, was allowed to creep into existence in 1933 and into public acknowledgement in 1934.

In the interwar years the Foreign Office was never allowed to reach its prewar position of dominance, partly because of popular criticism of the 'old Diplomacy', and partly because Prime Ministers wished to run their own foreign policy. The importance of domestic issues in the politics of the 1920s placed foreign affairs in the shade and reduced the importance of diplomacy. When foreign affairs were forced back into centre stage in the 1930s, the Government, still distracted by domestic concerns, could not give to them the kind of scrutiny which they had received prior to 1914.<sup>48</sup>

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43. F. Leith-Ross, Money Talks: Fifty Years of International Finance (1968), p.247.

44. Peden, British Rearmament, p.60.

45. Leith-Ross, Money Talks, pp.106 & 133.

46. Middleton, 'Fiscal Policy', p.33.

47. F.T. Ashton-Gwatkin, The British Foreign Service (New York, 1950), p.19.

48. Kennedy, The Realities Behind Diplomacy, p.252.

There was, therefore, virtually no tradition in the field of international economic relations, and the machinery for economic diplomacy was rudimentary, (although the Bank of England had long carried on its own 'economic diplomacy' through its contacts with other central banks, and the establishment of the Bank for International Settlements provided a forum for further co-operation). In the 1930s Britain was only just beginning to realise that there was such a thing as economic foreign policy. Under the pre-1914 order international commercial and financial relations were controlled by businessmen. Perhaps for this reason business interests continued to enjoy great influence with the various government departments concerning the evolution of foreign economic policy. The government, in turn, depended upon the business world for information. J.H. Richardson thought that this development in the 1930s was a new feature in British politics.<sup>49</sup>

Whatever the response of individual sectors of industry and commerce to Imperial Preference, both financiers and industrialists wanted to see a return to a normal relationship in business with Germany. The British Government might have aspired to formulate a particular policy towards Germany, but in practice any policy was partly determined by extra-governmental agencies. There was a whole range of actors on the economic stage, from private entrepreneurs to public companies. The concept of policy must therefore be defined in correspondingly broad terms.

Thus the Government struggled to respond to an increasingly complex tangle of demands of the national economy and the dictates of foreign policy. During February 1936, for example, the Cabinet had to decide whether to increase the duty on dressed leather imports (see Chapter VII). British manufacturers won the argument for extra protection against imports from Germany. This case contradicts interpretations of British policy which suggest that vital commercial interests were sacrificed for the sake of political approaches.<sup>50</sup>

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49. Richardson, British Economic Foreign Policy, p.24.

50. As does Bennett, German Remarmament, p.379.



### iii) Methodological Approach.

As far as the methodological approach taken in this work is concerned, there is a major difficulty common to all research on this and similar topics: an over-dependence on governmental, as opposed to non-governmental, sources. The records of Cabinet discussions reveal little of the active debate on the issues already outlined. It is to the files of the different departments which one had to turn in order to understand the differences in thinking between ministers themselves and between their respective officials. The Treasury records are especially rewarding in this respect. In some cases it is possible to gain a different perspective by reference to the archives of the Bank of England, which occupied a quasi-governmental position. But it is on such records, and on those of representative organisations like the Federation of British Industries, that an assessment of the activities of the mass of commercial and industrial interests has to be based. For while several well known companies allow access to their archives for the purpose of research, the historian has only a limited knowledge of the views and policies of most companies in the private sector. In this respect, therefore, an important foundation of British financial and economic policy towards Germany remains partially hidden.

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## Chapter II

### The Standstill Agreements 1931-39.

It was common for British banks to grant medium-term loans to German states and municipalities. But much more important were the short-term credits made to German banks and industry. These loans were frozen under the Standstill Agreement which was a product of the inter-governmental conference which met in London in July 1931, as the world economic crisis deepened. The purpose of this chapter is to trace the course of the Standstill Agreements, as far as Britain and Germany are concerned, until the outbreak of the Second World War. A serious constraint is imposed on this task by the sparsity of the relevant archival material which is accessible. Nevertheless, by attempting to present a chronologically broad picture of the Standstill the intention is to create a framework within which British policy was carried out.

#### i) The First Standstill Year.

The Standstill has been discussed by Professor Sayers and Sir Henry Clay, while much more recently the significance for Germany of the first year of agreements has been analysed in an excellent thesis by Harold James.<sup>1</sup> In 1931 British banks had Rm922 million short-term money in Germany. The dangerous levels of capital withdrawal from Germany was obviously a matter of grave concern to bankers worried about the security of their loans.<sup>2</sup> The acceptance houses were particularly involved in Germany. In the 1920s credit had been extended to Germany through the medium of German banks. At the time, this seemed to offer the acceptance houses sufficient security. But serious problems emerged when the German banking system itself was caught up in the financial crisis of the early 1930s.

It was this particular aspect of German indebtedness which, Sayers claims, led the Bank of England into a course of unprecedented action which was to stretch past the beginning of the war. The Governor of the Bank felt compelled, albeit reluctantly, to prevent what he took to be the imminent breakdown of Germany's international trading system and the consequent disastrous blow to the chances of world economic recovery. It was this continuing broad concern, rather than a conventional interest in factors affecting City firms, which determined the Bank's involvement. The Bank of England also believed that the lending carried out by London's bankers had been reasonably related to the growth of Germany's foreign trade, and that if an international collapse could be averted bankers could be left to look after themselves.<sup>3</sup> More than this, the London creditors

were considered to have been more prudent than others - a point of particular significance for interpreting events later in the decade.

Thus Montagu Norman seems to have stressed the importance of banks maintaining their credits in Germany; he supposed that attempts to call them in would probably fail and precipitate a worse collapse. But he was not prepared to take direct action at this stage. In mid June he told British bankers that he would not take responsibility for the maintenance of German credit.<sup>4</sup> This led to an agreed policy organized by a committee of clearing banks and acceptance houses. Through Norman and Harrison (Governor of the New York Federal Reserve Bank), the New York bankers were approached and an identical policy was adopted there.<sup>5</sup>

On 15 July the Governor met the committee and declared firstly that renewal bills would not be eligible for rediscount at the Bank of England and secondly that he was not prepared to make advances to houses to carry frozen positions arising out of the difficulties which then obtained.<sup>6</sup> At the London Conference, the bankers then sought to extract a guarantee of German foreign credit from either the German government or industry. But their demands were too ambitious.<sup>7</sup>

When Montagu Norman met the committee again on 25 July, he handed to them a copy of a letter received from the Treasury asking for co-operation in carrying into effect the proposals recommended by the Conference. This was that the volume of credit already extended to Germany should be retained there and that German credit requirements be discussed by a special committee. A committee of experts was thus drawn up to investigate the German short-term debt situation and negotiate with the debtors. Its chairman was the American, Albert Wiggin and it included Sir Walter Layton.

But the major consequence of the Conference was that the \$100 million Central Bank credit to Germany, which had been granted equally by the Banks of England

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1.R.S. Sayers, The Bank of England, 1891-1944 (Cambridge,1976),II. H. Clay, Lord Norman (1957).

H. James, 'The Reichsbank and Public Finance in Germany, 1924-1933' (unpublished Ph.D. thesis,University of Cambridge, 1982).

2. James, 'The Reichsbank',p.220.

3.Sayers, Bank of England,p.502-5.

4.James, 'The Reichsbank',p.220.

5.Clay, Lord Norman,p.381.

6.Bank of England Archives (hereafter BE),OV34/129.

7.James,'The Reichsbank',p.220.

and France, BIS, and the New York Federal Reserve Bank, was renewed. This ensured that there was no German credit collapse and was the essential prerequisite for achieving the bankers' co-operation. For when the London bankers asked Norman on 25 July whether any guarantee would be forthcoming from the British Government they were told that this was out of the question, more especially as it would have been entirely contrary to the attitude adopted by the Government at the Conference.<sup>8</sup>

But with the commitment to renew the Central Bank credit, the bankers agreed not to withdraw their credits and also helped, thereby, to ensure that German banks did not close their doors. Negotiations eventually led to the Standstill Agreement on 19 September, which was designed to run for six months. All the ten creditor nations of Germany were signatories. Existing credits were frozen on their original terms, but service was guaranteed. According to Ellis, the Agreement only covered between one third and one half of Germany's aggregate short-term debt, although estimates of this figure vary widely.<sup>9</sup>

The German authorities had wanted the credit lines frozen at their level on 13 July. Instead, 31 July was taken as the operative date. This meant that the credit lines were significantly reduced to an approximate total of £300 million.<sup>10</sup> For the London banks and acceptance houses the credit lines extended to German bank debtors amounted to £46 million and to German commerce and industry some £18.5 million, a total of some £65 million.<sup>11</sup>

Naturally creditors hoped that by treating Germany favourably - both politically and economically - they could ensure that they would not lose too much. But the Agreement could only operate if creditors did not feel that Devisen was being allocated illegitimately for Devisen flight or for reducing long-term debt. In practice it meant that, "the Standstill was the foreign counter-part to the Reichsbank's domestic control of foreign exchange". Without it German currency control would have appeared as an arbitrary and unilateral German default.<sup>12</sup>

A provision of the Agreement was that there was to be no discrimination between the creditors. They were also to be provided with bills, eligible for acceptance, by the German debtors. If the creditors were not satisfied as to eligibility, the obligation was to be carried as a cash advance.

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8.BE OV34/129.

9.Ellis, Exchange Control, p.171.

10.BE OV34/149.

11. *ibid.* and OV34/131. This total was later thought to have been an over-estimate (by about £10million) although it continued in use.

Thus it was ensured that the debts would be represented, as far as possible, by bills that were readily marketable in London. Provision was also made for a reduction in the total credit lines: the Goldskontbank could be required to take over 10 per cent of the acceptance credits.

Although the Governor of the Bank of England was emphatic in rejecting any possibility of a governmental guarantee, Clay maintains that he did promise that if the position of the acceptance houses or clearing banks which gave them credits came into such jeopardy that it constituted a national crisis, he would take it up with the Government.<sup>13</sup> Nevertheless, according to a letter from Leith-Ross to Sargent (head of the Foreign Office's Central Department until 1933 when he became Assistant Under-Secretary), the Governor was not prepared to define conditions for an extension of the Standstill and felt doubtful whether the U.K. could afford to extend it all.<sup>14</sup>

In a further letter some days later Leith-Ross stated that it would be hard to exaggerate the vital importance to Britain of securing the restoration of Germany's credit before the termination of the Standstill. This was an interest not only of the City but of the whole commerce of the country. It was also, Leith-Ross continued, a direct interest of the Government as British bankers would certainly argue that they only entered into the Standstill Agreement at the request of the Government. They would therefore expect the Government to secure that they were safeguarded against loss as the result of this action. Leith-Ross did not accept this argument unreservedly. But he saw what an extremely awkward matter it would be for the Government if such commercial obligations, which should be naturally self-liquidating, could not be met owing to the demands made on Germany by her Reparations creditors. At the same time he recalled that, under the Young Plan and the Hague Agreement, the Versailles Treaty provisions making Reparations a first charge on German assets had been definitely abrogated.<sup>15</sup>

Rowe-Dutton, the Financial Advisor to the Berlin Embassy, gave some credence to these arguments. He reported that the financial problems which faced Germany had been largely occasioned by outside action, in particular by the decision of Germany's creditors to withdraw their advances and by Britain's departure from Gold. Rowe-Dutton did not absolve Germany from responsibility, but he saw that she needed to make a tremendous effort in order to adjust and he doubted whether there was any room for sacrifice or compromise.<sup>16</sup>

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12. James 'The Reichsbank', p.217.

13. Clay, Lord Norman, p.381.

14. FO 15212, 31 Oct. 1931. See also T160 436 12630/02/1.

15. T 188 33; FO 15212, 3 Nov. 1931.

As he was to show on many occasions in the 1930s, Leith-Ross was accurate in his forecasting. When he met the committee of bankers in November, it emerged that they did indeed expect the Government to secure suspension of Reparations until German commercial credit was completely restored. However, Leith-Ross would not admit publicly what he had confided to Sargent. He told the bankers that the Government had only put forward the Standstill scheme for consideration and that if the bankers had had a better idea it was up to them to have put it forward.<sup>17</sup>

No sooner had the Standstill Agreement been made than the creditors became concerned with its possible renewal in February 1932. But next to no progress had been made at governmental level in achieving a solution to the Reparations question before the Hoover Moratorium came to an end. For this reason, the committee of bankers took the unusual step of submitting a memorandum on the Standstill question to the Bank of England. The document found its way, of course, to the Treasury and from there it was circulated, in slightly amended form, to the Cabinet.

The committee felt the need to justify the actions of the British banking institutions which appeared to them to be the subject of widespread public misunderstanding. The City of London had for many decades financed German trade to a large extent by means of acceptances. Before the First World War this was done partly by the acceptances of the big German banks with their active branches in London. Subsequently it had been carried out by the Joint Stock Banks and acceptance houses.

There were no figures available to show whether the amount of sterling acceptances for German account were larger after the war than before. It was certain, at any rate, that before the war they were considerable. The bankers did not regard the amount of acceptance credits covered by the Standstill as excessive for London to have granted to a great country like Germany with a vast import and export trade. The business had operated for many years on a large scale with safety; credits were granted partly to the strongest banking institutions and partly to the best commercial firms with whom London had had business connections over a long period of time. No exceptional profits had been made, it was claimed. London institutions had indeed done nothing more than to transact their normal business with Germany which, the memorandum noted, was essential for the smooth working of British and world commerce.

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16. FO 15212.

17. T 188 33, note of discussion, 20 Nov. 1931.

But while British bankers were aware that additional loans had been made to fill the vacuum of working capital in Germany since the war, they had had little idea how large the figure was. Such circumstances had produced a situation in the London market which the bankers thought was, quite simply, "unprecedented in times of peace". Unparalleled developments in the outside world threatened for the first and only time, except at the outbreak of war in 1914, to cause serious difficulties.

The document detailed how bankers believed that they had faithfully fulfilled their undertaking, but that the risks they had run in agreeing to maintain credits were now more fully apparent. For it had become public knowledge that out of the total short-term indebtedness of Germany there was a very large sum not covered by the Standstill Agreement, and that the debts due to London bankers and acceptance houses represented a small fraction of that total. The committee was worried, therefore, that other creditors had received preferential treatment. But rather than raising the question of priority in legal terms, bankers were far more concerned to express their fear that they would be sacrificed to political exigencies if the British Government allowed the Reparations issue to imperil economic conditions. Then commercial claims would be subordinated to political debts and private creditors would not only continue by all means possible to withdraw their money from Germany, but would refuse to give any fresh credit. The result would be disastrous to the whole world and incidentally fatal to any hope of further Reparation payments. Finally, the bankers' memorandum called on the Government to be prepared to stand behind its nationals if there was to be a further Standstill through political difficulties.

In the copy of the memorandum in the Bank of England, it was additionally noted that foreign creditors proposed not to renew the Standstill unless, in the words of the Wiggin-Layton Committee, "the international payments to be made by Germany will not be such as to imperil the maintenance of her financial stability." A second condition was that the German Government would have arranged some satisfactory scheme for postponing the payment of foreign short-term debts from German debtors outside the Standstill.<sup>18</sup>

The German Government was quick to exploit this position. The German Ambassador in London produced a memorandum - this time for the Foreign Office - which claimed that it could be confidently stated that German foreign indebtedness was considerably higher than it was supposed to be when the Wiggin-Layton report was drafted. The German document announced that the

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18. CAB 24/255 (306); T 160 438 12681/01; BE OV34/149, Memo. 30 Nov. 1931. In January 1932 the committee of banks and acceptance houses changed its name to the Joint Committee of British Short-Term Creditors.



entire foreign indebtedness had reached Rm 28-29 billion, and that it would be impossible to pay short-term debts when the Standstill expired. Vansittart commented that that meant the end of Reparations, which must have been precisely the response hoped for by the German Government.<sup>19</sup>

The negotiations for the renewal of the Standstill Agreement therefore laboured under the dual problem of the Reparations issue and Germany's other debts. In addition, relations between the ten creditor countries were far from harmonious. Many difficulties were successfully tackled by an arbitration committee set up by the BIS. British banks wished to limit the arrangements for the renewal of the Standstill to the safeguarding of bank credit. For while they had lent money to German industry, it was not so much as the French and especially the Swiss and the Dutch. The Americans were irritated because they thought the British had profited excessively under the old arrangement. Because of the fall in sterling, which was widely expected to be only temporary, German debtors had attempted to take advantage of what looked like a unique opportunity to repay sterling debts.<sup>20</sup>

Indeed, whether the Standstill laid the basis for the discontinuance of German exchange control cannot be known for within a few days of signing the Agreement, Britain left the Gold Standard. The Reichsbank consequently lost Rm 66 million in Devisen in the following week and exchange control was tightened.<sup>21</sup> One member of the British Joint Committee was the Lazard Brothers' partner R.H. Brand. He was also a member of the Joint Committee of Representatives of Foreign Bankers' Committees (of Germany). From Berlin, he sent a full report concerning the prolongation of the Standstill to Sir John Simon, newly appointed Foreign Secretary in MacDonald's Second National Government. Brand repeated that the Germans would have to satisfy the Committee that creditors outside the Standstill would not be repaid. He thought he had grasped a simple truth - which all short-term creditors would be able to view if gradually educated - that a liquidation policy, or attempts to get debts repaid in cash, would be fatal. Rather, he believed that the best chance was to strengthen Germany and the Reichsbank so that most creditors would voluntarily leave their money there. He agreed that the creditors' position could get much worse and that they might have to wait a long time. But he thought that whenever creditors got together it was difficult for any idea to oust the paramount one of squeezing the lemon as hard as possible.

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19. FO 15212, Memo. 23 Oct. 1931.

20. James, 'The Reichsbank', p.228-9. Figures produced by British banks and acceptance houses (known as 'returns') would seem to contradict James's assertion that British banks had lent no money to German industry.

21. Ellis, Exchange Control, p.171.



Brand also cited the risks involved which made it impossible to have a long agreement, or so he thought. A great danger for London was that while Germany would be unable to find the exchange to repay the Standstill credits, German exporters and importers would make less and less use of them for various reasons such as the shrinkage of trade and particularly the desire to avoid exchange risks. In that event the Standstill would become a sort of shell with the Germans owing the money but not producing the bills to make London's machinery work, thus forcing all creditors into cash advances.<sup>22</sup>

The most heavily committed British bank was J. Henry Schröder, just as Chase was in America. Thus like Wiggin (of Chase), the Schroders' partner F.C. Tiarks was also obliged to be friendly to Germany.<sup>23</sup> Tiarks took a leading role in securing the first Standstill Agreement and with Brand was to continue to play a significant part in the arrangements. As a Director of the Bank of England he also kept Montagu Norman directly informed of developments.<sup>24</sup> Indeed, Tiarks was appointed the chairman of the committee of foreign bankers, a particularly influential position.

Stephanie Diaper, in a recent thesis on the City house of Kleinworts, has examined the effects of the Standstill on this company's acceptance business. Kleinworts were especially hard hit: their acceptances involved in the Standstill represented roughly one tenth of the amount owed to the London banks generally. Acceptance business fell in the course of 1931 from £17.7 million to £12.1 million. At the end of July 1931 Kleinworts had £15.7 million outstanding and of this £5.8 million was on account of German companies. They also had a further £3.5 million outstanding in advances and deposits in Germany.<sup>25</sup> Kleinworts's lending-to-capital ratio was also a problem: it seems that it was higher than that of other houses, and therefore Kleinworts looked more vulnerable.

In comparison, the commitments of a clearing bank, the Midland, appear light. Under the original Standstill the Midland's total commitments as creditors of German banks amounted to just over £3.5 million (Deutsche Bank some £1.5 million, Dresdner Bank £880,000). Commitments outside the Standstill amounted to £615,000. By the time of the 1938 agreement the total for all banks had been reduced to £2.7 million, and in response to a letter from the Bank of England in June 1938 concerning the threatened trade clearing with Germany, the Midland returned details of its credits to Germany outside the Standstill which amounted to £480,000.<sup>26</sup>

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22. FO 15935 C31, Letter 30 Dec. 1931; See also T160 450 13050.

23. F.C. Tiarks was the son of Henry Friederich Tiarks who became a partner in Schröders in 1871.

In early December Brand and Tiarks met Flandin, the French Finance Minister, in Paris. It emerged from the conversations that a scheme was being taken to Berlin although it was not anticipated that either creditors or debtors would sign anything until the outcome of the Reparations question was known. The foreign bank creditors wanted to hand a letter to the German Government which made plain that the Standstill could only continue if the Reparations issue was settled. But the French would not agree to this point nor would the Americans because of war debts.<sup>27</sup>

The Standstill Agreement was renewed on 22 January. Known as the German Credit Agreement of 1932, it was to run for a year from the end of February. There was a fair amount of surprise that all the foreign creditors had actually agreed, especially as neither of the two most important conditions was secured.<sup>28</sup> It proved impossible to include the short-term debts of the German States and municipalities. And in January, the British Government agreed with the German Government that postponement of the Reparations conference until July was necessary.

But an important addition to the agreement was that of clause 10. Under this 'Swiss Clause' (so-called after the creditors who suggested it) creditors were able to utilize a maximum of 50 per cent of their advances for purchases of German securities (capital participation). These, however, remained blocked for five years; this was the origin of one category in the system of blocked marks. The agreement also provided for a reduction of principal sums by 10 per cent and for further reductions to be discussed at quarterly meetings. Yet, according to Ellis, total Reichsmark credits had already been reduced by 20 per cent by repayments and sterling depreciation.<sup>29</sup> The German debtors also secured a promise that interest rates would be reduced to some conformity with rates in creditor countries.

On the day the agreement was renewed the Foreign Creditors Standstill Committee issued a report which echoed Brand's earlier letter. It blamed the acute financial crisis in Germany on recent excessive withdrawals of capital, which were caused by a lack of confidence not justified by the economic and

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24. Sayers, Bank of England, p.503.

25. S. Diaper, 'The History of Kleinwort, Sons & Co., in Merchant Banking, 1855-1961' (unpublished Ph.D. thesis, University of Nottingham, 1983), p.227-8.

26. Midland Bank Archives (hereafter MB), 30/190 & 191.

27. T 160 438 12681/01, Memo. by Rowe-Dutton, 10 Dec. 1931.

28. BE OV34/130.

29. Ellis, Exchange Control, p.178.

budgetary situation of the country. The report maintained that the short-term debts covered by the agreement represented funds which were used for business purposes and which, on the whole, were soundly used.<sup>30</sup>

After the agreement was signed it was noted in Whitehall that all the creditors would have liked to get out of the Standstill if they could, but that it was "typical" that only the French and Americans appeared to be doing so. Leith-Ross noted that the French had been making desperate efforts to get their money out of Germany and the Banque de Paris was said to have got back 40 per cent of its money in the course of the first Standstill year.<sup>31</sup> At the same time the French Central bank was causing concern. In the middle of February Chamberlain wrote one of his regular letters to his sisters in which he reported that the bankers would renew the Standstill provided the French did not refuse to renew the credit granted to the Reichsbank: "the French have been very tiresome about it but I hope now they will be more reasonable".<sup>32</sup> Leith-Ross thought that the attitude of the Bank of France was dictated by their parochial conception of banking policy (rather than out of a desire to pressurize Germany over Reparations), and that it was absurd that such matters should be treated like questions of pawnbroking.<sup>33</sup>

Some months later the Foreign Office asked the Berlin Embassy to confirm the accuracy of a City source which had informed them that the liquidation of the Standstill continued apace. More and more methods of payment behind it seemed to have been found. It was thought that the whole arrangement would have already ceased to exist but for the fact that the Americans would immediately try to recall all their credits.<sup>34</sup>

The City source referred to was probably Nigel Law, who was once an official in the Foreign Office. He regularly informed Sargent of developments in the Stillhalte arrangements. The London committee towards the end of March, endeavoured to persuade the London banks and acceptance houses to reduce the rates they charged German debtors. But a number of banks considered that the minimum 5 per cent on German short-term credit was too low; it was proposed that it should be 2 per cent above Bank Rate, namely 6 per cent.<sup>35</sup> At the same time, the City was much incensed at the Reichsbank's attempts to force a reduction in rates by refusing transfer facilities for the interest

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30. FO 15935.

31. FO 15935 C1042, note by Perowne and letter FLR to Sargent, 3 Feb. 1932.

32. University of Birmingham Library, Neville Chamberlain papers (hereafter NC) 18/1/770, to Hilda, 13 Feb. 1932.

33. FO 15936 C1322, FLR to Sargent, 10 Feb. 1932.

34. FO 15937, undated FO despatch to Ambassador Rumbold.

35. MB 30/99 Hyde's Diary, p180, 21 March 1932.

on loans running at rates above 7 per cent,<sup>36</sup> This caused widespread nervousness abroad, with fears that the German Government might have to declare a moratorium. The rate was cut by the creditors to 6 per cent for bank loans and to 7 per cent for non-bank loans. In July, the rates were further reduced to 5 per cent and 6 per cent respectively.<sup>37</sup> At the London Standstill conference held on 1 July, it was agreed that the pre-requisite for termination of the agreement would be the freeing of the German exchange which in turn depended on what happened at Lausanne. It was hoped that when the time was ripe an attempt would be made to reduce the amount of financing by freeing large blocks of credits in succession. About 60 per cent of the total outstanding credit granted by Britain was thought to be recoverable, even in the event of a financial collapse in Germany, although it was not made clear how this would be done. Paradoxically, it seemed probable that if circumstances permitted the abolition of the agreement, London credits granted to Germany would tend to increase, for even in 1932 some fresh credits had been granted.<sup>38</sup>

As 1932 progressed attention began to focus on the effect of the Standstill in conjunction with German exchange control on Anglo-German trade. Credit lines open under the Standstill were utilized in the following fashion. The German importer asked a German bank into which he had paid the necessary funds and which had an open reimbursement account with a British bank, to draw on the latter. Once the bill had been accepted by the British bank it was discountable anywhere and the British exporter could thus obtain payment immediately. As far as the British bank was concerned, the amount was treated as part of the monies subject to the Standstill terms.

The British Embassy in Berlin was told that 'blocked' accounts could be made use of, provided they were employed for the payment of additional German exports which would otherwise not be effected. Rumbold advised waiting to see the extent of injury to British firms from exchange control before deciding whether a payments clearing agreement with Germany was advisable or not. This is one of the earliest references to the idea that Anglo-German trade should be so conducted; it was an idea which was to be repeatedly raised throughout the decade.<sup>39</sup>

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36. FO 15903 C2451, Law to Sargent, 23 March 1932.

37. James, 'The Reichsbank', p.242.

38. FO 15903 C5937, Law to Sargent, 7 July 1932.

39. FO 15937 C5771, Rumbold despatch, 2 July 1932.

There was no doubt that the embargo placed by the German Government on payments abroad damaged the British export trade to that country. A representative of the U.K. textile industry explained how German manufacturers were only allowed to buy foreign currency to the extent of 55 per cent of half the value of goods imported in 1930-1. This made it almost impossible to sell British goods and compelled German manufacturers to buy inferior goods in Germany. It was felt that immediate steps had to be taken if one of Britain's best customers was not to cease buying English yarns altogether.<sup>40</sup>

Olex, the German subsidiary of the Anglo-Persian Oil Company, was to experience severe trading difficulties under National Socialism. Yet, even in 1932 they were compelled to negotiate a type of barter arrangement. Olex placed an order in the Rhineland for £200,000 worth of material for a pipe line they were constructing, which was to be paid for in sterling. The Reichswirtschaftsministerium agreed that Olex could have the sterling resold to them in order to purchase petrol to import into Germany. Alternatively, they had permission to pay for their pipe line in marks from blocked accounts in Germany. <sup>41</sup>

The Board of Trade began to feel that the attitude of the German authorities and the German banking committee was decidedly unsatisfactory. It was noted that Holland-Martin, probably in his capacity as a Director of the Bank of England, had been making enquiries as to whether there were any British Government payments which could be met out of blocked Reichsmark balances. The Board of Trade thought that the contention that the use of such balances to pay trade debts would deprive Germany of foreign exchange implied that British holders of the balances were to be forced to pay their German debts in sterling, although they were not parties to the Standstill. The Board had always taken the general line on exchange that British traders should not be placed in a position less favourable than those of any other country. They saw no reason why they should refrain from doing so in the case of Germany.<sup>42</sup>

As far as Standstill funds were concerned, the German Committee for the 1932 Credit Agreement wrote to Brand to point out that these could be used in Germany only for long-term investment, as under clause 10. For the essential purpose of the Standstill was to protect the foreign exchange situation of the Reichsbank. It was not possible, therefore, to allow Standstill funds to be used to settle German claims, as this would deprive the Reichsbank of foreign funds. Instead, the funds could be used to facilitate additional exports.<sup>43</sup>

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40. T 160 927 12750/2, F.Spencer of Fine Spinners to British Consulate General, Cologne, 22 April 1932.

41. *ibid.* Rowe-Dutton (Berlin) to SDW, 1 June 1932.

42. FO 15937, Jenkins (Board of Trade) to Pinsent (Treasury) 26 Aug. 1932.

Pinsent, who was soon to succeed Rowe-Dutton, could not agree with the Board of Trade that the German attitude was unsatisfactory. Nor was he surprised that additional exports were desired. The question, as he saw it, was whether the Germans could be persuaded to relax exchange restrictions. Attempts had to be made, independently of bankers, to secure the release of some of the traders' balances.<sup>44</sup>

In the Bank of England Rodd agreed that it was difficult to rail at a principle which was fundamental to the Standstill. The situation was aggravated by the diversity of interests involved; commercial creditors could not make their voice heard in Germany. Rodd thought that the bankers would be happy to co-operate, but the machinery did not exist. He confirmed that the liquidation of blocked accounts was taking place - on a very considerable scale - where it served German interests. There was thus a large market in blocked marks as bankers liquidated, although they did so at a discount. Many transactions were carried out over Zurich at a 22 per cent discount, while Americans were liquidating at 30 per cent, a rate unacceptable for London. Rowe-Dutton drew the obvious but nonetheless highly significant conclusion from this that bankers' and traders' interests were different.<sup>45</sup>

This was illustrated by the Foreign Office attempts to obtain some relief for British commercial interests by proposing to the British Embassy that some kind of Anglo-German negotiation be entered into to secure the release of frozen credits. Rowe-Dutton felt that Britain was not in a position to employ either bribery or force in any negotiations. But more than this, any unfreezing of blocked mark accounts might worsen Germany's Devisen position. Commercial and banking interests were not, therefore, altogether compatible, and negotiations for the relief of commercial interests could run counter to negotiations between the Standstill creditors and the German Foreign Debts Committee.<sup>46</sup>

It also became clear that the German Government would not consider any scheme by which frozen credits could be used for the payment of exports from Germany. Foreign exchange from exports had to flow to the Reichsbank to meet debts. Frozen credits could be used in payment for additional exports, but that would bring German goods into increased competition with British ones. Rowe-Dutton thought that policy ought not to concentrate on protecting the position of banking creditors rather than securing relief for commercial interests, while Edwards (Commercial Counsellor at the Embassy) thought that the former ought to be actually subordinate to the latter.<sup>47</sup>

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43. T 160 927 12750/3, 9 Aug. 1932.

44. *ibid.* Pinsent to Siepmann (Bank of Eng.), 1 Sept. 1932.

45. *ibid.* Rodd to Pinsent, 9 Sept. 1932.



Leith-Ross also saw that interests were not compatible. While he thought that banks recognised the desirability of liquidating trade debts he also believed that the stoppage of acceptance business was one of the most formidable obstacles to the revival of British export trade. Thus if the Devisen position was not to be endangered, blocked accounts could only be slowly liquidated.<sup>48</sup>

At the request of Sir Walter Layton the Joint Committee circulated a memorandum on all the different aspects of the problem of transferring Reichsmarks into foreign exchange. The great difficulty in transferring or exchanging Standstill money proved clearly that the Standstill had become an institution by which the Reichsbank protected the foreign deposits of the German banks. The memorandum also looked at the function of Sperrmarks- the balances blocked under the Emergency Decrees. Because of increasing trade barriers, depreciation of sterling, the fall in the price of commodities and the stabilisation of the mark at dollar prices, exporting had become very difficult for Germany. The Reichswirtschaft-Ministerium had given permission to exporters to use Sperrmarks, which they obtained at a considerable discount (20-24 per cent), in part payment for exports. Similarly employed were liquidated foreign-held German securities or German bonds in dollars or sterling. They commanded considerably higher prices inside Germany than abroad, and the German exporter used the difference to cover his loss in respect of sales, mainly to the U.K., where, it was claimed, sterling depreciation had made it impossible to conduct business in the normal way.

It is obvious from this document that bankers were not unhappy with this 'natural' development of finding buyers of frozen accounts, and the continuous increase in finding new methods of using such accounts. For it assisted the international trade of Germany. The only real criticism was reserved for the burden created by German officialdom. In order to protect the banks and private firms the German authorities placed great obstacles in the way of trade development.<sup>49</sup>

The loans to German municipalities and states which had not been included in the renewed Credit Agreement were the subject of their own Standstill, the German Public Debtors Agreement of April 1932. Like the main Standstill it was made for one year and provided for a reduction of 10 per cent in the principal sum.

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46. FO 15954 C8042, Rowe-Dutton to FLR, 15 Sept. 1932.

47. *ibid.* Memo. by Rowe-Dutton, 14 Oct. 1932.

48. *ibid.* FLR to Rowe-Dutton, 22 Oct. 1932.

49. FO 15937 C8624, Memo.No.8 (Financial Series), 30 Sept. 1932.

Kleinworts were the major participant. Late in 1931 a representative of the bank explained the difficulties involved to the Foreign Office. The banker felt that British firms had been 'let in' over municipal short-term loans because, firstly, they had not realized that the German towns were borrowing so heavily and secondly, they did not realize that the Germans were going to use these short-term loans for long-term purposes. Apparently it was not usual for a firm to ask municipalities what they intended to do with the money when borrowing for three months. Presumably, the municipalities had been regarded as having sufficiently good credit. The Foreign Office reaction was one not far short of contempt. Sargent minuted that this was a feeble case. He felt that the French were justified in saying that the English financial houses had only themselves to blame for being in such a mess. Vansittart declared that what was "not usual" had better become "inviolable" in the future; he was amazed at such an avowal and way of doing business.<sup>50</sup>

By the end of March 1939 the total outstanding under the German Public Debtors Agreement amounted to £1,021,000 of which Britain accounted for £975,000.

These amounts were insignificant in comparison with the sums outstanding under the Standstill proper.<sup>51</sup>

## ii) The Standstill under National Socialism.

The National Socialists did not change the fundamentals of financial and economic policy when they achieved power in 1933. Rather, under Hjalmar Schacht, Reichsbank President from 1933-39 and Reichswirtschaftsminister 1934-37, basic policies were extended. Even if its very existence was threatened by the extreme measures to which Schacht resorted, the Standstill continued to be viewed as one such instrument of policy.

This is illustrated by a conversation in February 1933 between Thelwall, the new Commercial Counsellor to the Berlin Embassy, and Tiarks as the latter was leaving Berlin after Standstill negotiations. Thelwall asked what would happen when Germany ran out of Devisen. Tiarks answered that the German authorities would stop transferring the amortisation on all foreign loans (except Dawes and Young), and after paying for necessary imports they would pay their obligations under the Standstill. Thelwall's retort, that one could not discriminate between creditors in such a fashion, annoyed Tiarks who thought that there was a tremendous difference between an investment in a bond and the obligation arising out of a commercial bill. A default on the first just affected the pockets of individuals, while the meeting of a bill was a matter of life or death to a debtor as otherwise his trading broke down. Thelwall noted: "I did not make the obvious reply that since 1931 the exact opposite had happened and that Germany had by the very Standstill itself defaulted on an enormous mass of short-term bills but had continued to meet the



service of long-term debts and that this fact had not damaged her foreign trade."<sup>52</sup>

A substantial amount of the credit at the disposal of German debtors was not utilised at the expiration of the 1932 Agreement. In the 1933 Agreement, therefore, unavailed credit lines were cancelled. In return, interest rates were further reduced.<sup>53</sup> The American and French creditors continued along the road of liquidation. The French, by this time, had become by far the biggest converter of blocked accounts into Register marks which were released to finance additional exports and travel inside Germany.

The American banker, Warburg, proposed a scheme for the funding of the whole Standstill position. Holland-Martin noted that a difficulty arose at once of deciding which were genuine self-liquidating credits which could be left as they were. He thought that probably the greatest proportion of "bad" business had been done by the U.S. banks and the "smartest" by the British banks. The U.S. banks regarded the Standstill position as one which had to be liquidated as soon as possible. But the British attitude was rather that of being willing to grant credits to Germany free of restrictions, up to an equal or possibly even greater amount than was outstanding, for genuine short-term finance of trade.<sup>54</sup>

By 1934, it was felt in the Treasury that the short-term creditors had fared better than Germany's other creditors. Because of this it was hoped, rather naively, that a time might come when the Standstill creditors might not want repayment, thus leaving a larger surplus for other creditors.<sup>55</sup> The American creditors achieved an enormous reduction in both credit lines and availments. Repayments of American credits were, to some extent, counter-balanced by fresh drawings in the case of other creditor countries. In Britain's case, availments actually increased.

Nevertheless, the shrinkage in Germany's total foreign trade obviously required a decreasing amount of foreign credit, which would show itself in a growing gap between credit lines and availments. Every repayment meant a loss of foreign exchange just as every reavailment meant a gain in foreign exchange. It was possible to argue, therefore, that a decrease in reavailments damaged Germany's foreign exchange position.<sup>56</sup>

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50. FO 15212, Memo. 10 Nov. 1931.

51. MB 30/202.

52. BE OV34/132, Thelwall to Pinsent, 17 Feb. 1933.

53. *ibid.*

54. BE OV34/133, Note by Holland-Martin, 10 April 1933.

55. T 160 817 12681/05/1.

Apart from forcing bondholders to go short of interest, Germany was managing to get out of her foreign debt at a prodigious rate. The first reduction in the Standstill to 1932 represented sterling depreciation. The second to February 1933 represented actual transfers and the third reduction to March 1934 was largely due to the devaluation of the dollar. The original Standstill seems to have embraced Rm 6.3 billion; Ellis claims that by 1934 this had been reduced to Rm 1.5 billion. The latter figure, however, would seem to be too low. A memorandum received by the Bank of England cites a figure of Rm 2.8 billion. This is supported by a memorandum by the German Standstill Committee, presented to the conference of 1935, which indicates that German Standstill indebtedness had decreased to less than one third of its original figure.<sup>57</sup>

By 1935 the distribution of the Standstill credits was quite different from what it was in 1931. Britain had clearly replaced the United States as the biggest creditor.<sup>58</sup> Thus Sayers is correct to point out that after 1934, when other creditors had largely pulled out on what terms they could get, the Standstill became mainly an Anglo-German problem. The British creditors were not in a hurry to liquidate as their long-standing business connections with Germany allowed them to hope that they would benefit, sooner or later, from the revival of Germany's international trade.<sup>59</sup>

But the position of Britain's short-term creditors was far from secure. Early in 1935 Dr. Schacht appeared to jeopardize the chances of renewing the Standstill. He wrote to Tiarks stating that it would no longer be possible to pay interest at the existing rates and that he was gravely concerned as to whether it would be possible to continue, unrestricted, the existing preferential position of the Standstill vis-à-vis other creditors as regards transfer of interest. This was the first time, it was noted, that Schacht had questioned the special position of the Standstill.<sup>60</sup>

Nevertheless, Schacht still appeared to value the agreements highly. Perhaps he was thinking as a banker rather than Reichsminister when he claimed that an essential part of the Standstill agreements was that they had always been concluded without political assistance. He believed that the Standstill was probably the only international agreement which had been maintained throughout the whole economic crisis; he hoped that it would be possible to maintain it until Germany returned to an economy free from Devisen restrictions.<sup>61</sup>

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56. *ibid.* Memo. by Rowe-Dutton, 3 May 1934.

57. Ellis, Exchange Control, p.193; BE OV34/133, memo. by Mendel and Nenck Ltd.

3 Feb. 1934; BE OV34/135, German Committee Memo. Figures quoted in American billions. The Mendel document suggests that Germany gained Rm 500 million by the depreciation of the dollar alone.

There can be not doubt that Tiarks believed in Schacht's good faith. Some months earlier Tiarks had told Brand that Schacht was firm in his purpose to look after the Standstill credits.<sup>62</sup>

In the Bank of England Siepmann, (Adviser to the Governors), composed a note on the likely instructions of the London creditors to their delegates for the Berlin negotiations in 1935. The suspension of capital repayments for a further year would not be resisted. But the trend towards barter and compensation deals in German trade posed new problems: like clearing agreements they tended to reduce the trade available for cover by Standstill bills. An attempt was therefore to be made to bring such agreements into the scope of the Standstill, or at least where the granting of new credits by British banks was concerned, such as the trade in S. African wool. The tendency towards such trade diversion was just one reason why, it was felt, the quality of Standstill bills would progressively deteriorate. The rigid control of German imports and exports, which interfered with the direct debtor-creditor relationship, tended to make the German authorities the arbiter not merely of what foreign exchange would be allocated but also what bills were to be drawn.

There were indications that Germany did not find such tendencies unwelcome. If the time was approaching when the service was not to be transferred in full, then the Standstill arrangement would have to be revised. Siepmann questioned whether, faced with the prospect of deterioration, the acceptance houses as a whole would not do better to split the Standstill by salvaging the good credits while they could. He also wondered whether the machinery did not require modification in order to put the creditors in direct touch with German authorities.<sup>63</sup>

While a basis for renewal acceptable to both Germans and international creditors continued to be found, the arrangements began to come under greater scrutiny from 1936. When a question was put down in Parliament concerning commercial credit granted to Germany, the answer proposed was that it could be said that the only important commercial credit was under the Standstill and that this

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58. T 160 817 12681/05/2; Financial Times 18 Feb. 1935.

59. Sayers, Bank of England, pp.503,508.

60. BE OV34/135.

61. *ibid.* letter to Tiarks, 2 Feb. 1935.

62. Bodleian Library, Oxford, R.H. Brand papers (hereafter Brand papers), File 190, letter 21 Aug. 1934.

63. BE OV34/135, note 31 Jan. 1935.

had been reduced from £65 million to approximately £43 million. In addition, it was suggested that, if it was asked that the Chancellor should obtain complete statistics of such credits, it could be pointed out that this was impracticable apart from the fact that the Government had no statutory powers to obtain the information.<sup>64</sup>

On 15 May 1936, Stopford, secretary to the Joint Committee, called at the Bank of England in connection with press comments about an increase in British Standstill credits to Germany during the preceding year and a related Parliamentary Question down for 19 May. On that day, the Joint Committee released a press statement with the intention that it should be used by the Government in the House of Commons. The idea that British bankers had increased their German credits in 1935 while every other country had reduced theirs was a misapprehension: no new credit could be granted under the Standstill. But one of the provisions of the Agreement obliged creditors to abide by a principle under which credits temporarily repaid in the normal course of business were still to remain available for re-use by the debtors in certain conditions. According to the press statement, it was unnecessary "to add that the maintenance of these frozen credits is exceedingly unwelcome to the Bankers concerned whose constant efforts have been and are devoted to obtaining repayment of them", and to securing the final cancellation of temporarily repaid credits. Indeed, credits worth over £2 million were so cancelled in 1935. Changes, such as the transfer from the German municipal agreement to the main agreement, and returns included in the British figures rather than, as previously, in those of other countries, were responsible for appearing to show an increase in used credits. But total credits, both used and unused, decreased by £1 million 1935. Larger reductions in the credits of other countries, the statement claimed, were mainly due to the willingness of creditors there to accept repayment in German currency with the heavy capital loss which that involved. In certain cases, too, governments assisted their nationals in obtaining repayment by special methods.<sup>65</sup>

It is perhaps instructive to examine, in the light of the available evidence, what Professor Sayers has to say about developments in the Standstill arrangements in the middle years of the decade. The London money market experienced a great scarcity of commercial paper at the end of 1934 and Standstill bills were traded at almost the best rates; the more questionable names among debtors had been gradually weeded out leaving "good" bills. At the same time, the experiences of that year - the British threat to impose a clearing arrangement on Germany - supposedly marked a turning point for the market. The Bank of England then began to express its wish, in various ways, that the

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64. BE OV34/137, proposed answer to Parliamentary Question.

65. *ibid.* note by C.F. Cobbold, 15 May 1936 and Press Statement by Joint Committee.

volume of bills should be reduced, and the City began tacitly to accept that realisation in full would never happen. The Bank continued the pretence that Standstill claims were 100 per cent but a "high authority" privately gave the opinion that the bills were worth only 45 to 50 per cent of their face value.

By August 1936 the Governor, Sayers continues, was warning the market that the Central European situation would have to be squarely faced, that a writing down of the debts was inevitable. On 28 September 1936, the Bank announced that from October 1937 the amount of Hungarian Standstill paper eligible at the Bank would be limited to half a million pounds for any one acceptor. The City institutions were not surprised, therefore, when on 17 March 1937, the Bank notified them that their liabilities on German Standstill bills should be reduced by 30 per cent by the end of September that year.<sup>66</sup>

The concern that liabilities should be reduced is evident from the attitude of the short-term creditors to the working of the 1934 Anglo-German Payments Agreement. Under this Agreement 10 per cent of the proceeds of German exports to Britain were set aside in order to liquidate outstanding trade debts. By 1936 this had been accomplished, and although there was no obligation on the part of the German authorities to allocate the 10 per cent for any other purposes, the Joint Committee, among others, lodged a claim with the Treasury that they should receive consideration for a portion of the allocation.

The claim was endorsed by Montagu Norman. He wrote to Hopkins that frozen banking credits did not differ in origin to trade debts but that they had taken second place on the grounds that traders could not wait for their money, but bankers could. Norman felt every sympathy with this request. It seemed to him to deserve serious consideration, both on its merits and because every opportunity had to be taken to reduce the great weight of Standstill debt with a view to liquefying the frozen positions in the City.<sup>67</sup>

Yet Cobbold, an Adviser to the Governors, minuted just a few days later that Beaumont Pease (Lloyds Bank) and Brand of the Joint Committee were concerned not to cause trouble with other Standstill committees through discrimination and not to give an opportunity to Germany to say that British creditors were now looking to the Government rather than to Germany for help.<sup>68</sup> Indeed, Beaumont Pease wrote to the chairman of the Acceptance Houses Committee to declare that although the Treasury had taken note of their claim there did not seem to be any way in which they could accept a share without discriminating against short-term creditors in other countries. And this would be a breach of the agreement.<sup>69</sup>

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66. Sayers, Bank of England, p.510; See also Clay, Lord Norman, p.449.

Gunston, another Bank of England official, left an intriguing record of the attitude of the London market. In October 1936 Gunston noted that the National Provincial Bank was prepared to accept payments in Register marks whereas previously they, like other London creditors and unlike the Americans, Swiss and so on, had only accepted these to a small extent. It was estimated that for the year 1936 this meant a loss to the bank of £1 million. Both Schacht and Tiarks wished to discourage this tendency. They wanted to maintain British credits to Germany at approximately their existing level because they felt that Germany would have need of British credits on this scale after the Standstill was wound up. They also both wished to maintain the banking relationship between Germany and London.<sup>70</sup>

Gunston subsequently noted that however instructive the Bank of England wished to be in relation to the dangers associated with Standstill bills, it seemed that some banks were very far from accepting that full realisation would be unobtainable. He detailed the reasons why British banks held the largest share of credit lines. They were the least inclined to write off their claims as worthless and they had refused to accept any discount. The British banks in general, therefore, maintained their credits in the belief that they would ultimately become good. Further, the market had not experienced any particular difficulties - Germany regularly transferred the service in sterling without interruption - which was more than could be said for other debts. It also had to be understood that British Standstill claims were regarded as first class banking credits expressed in sterling.<sup>71</sup>

### iii) Standstill Problems in 1937

By 1937, however, the deteriorating political situation in Europe was beginning to place the Standstill arrangement under considerable pressure. The cracks which began to appear from this time, both in the previously united front of British banking creditors and of the international creditors, were manifestations of the tensions which were building up in the Standstill arrangements.

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67. T 160 818 12681/05/3; BE OV34/203, letter 22 May 1936.

68. BE OV34/203, min. 25 May 1936.

69. MB 30/190, letter 22 June 1936.

70. BE OV34/137, note 29 Oct. 1936; FO 20724 C2072, letter, Law to Sargent, 11 March 1937.

71. *ibid.* note by Gunston, 10 Dec. 1936.



The clearing bankers met early in the New Year. They decided to inform the Governor and the Chancellor of the Exchequer that they were contemplating declining to carry their Standstill obligations on bills any longer unless some arrangement was made which led to the progressive capital reduction of the Standstill debts. The bankers hoped that this would add weight to the endeavours of Lidbury to gain assurances that the Government would try to amend the Payments Agreement, in order to gain a reduction of British Standstill credits. It was further decided to make these representations independently of the acceptance houses.<sup>72</sup>

For while the acceptance houses were prepared to renew the Standstill on existing terms for a further six months, the clearing banks, prompted by McKenna, Chairman of the Midland Bank, had become concerned that the Standstill creditors had refrained for three years from pressing for any capital repayment and had thereby assisted the financing of German rearmament. The clearing banks believed that matters had to be brought to a head: bills should no longer be accepted. It was appreciated that such action would cause great difficulties for the acceptance houses, but it was considered better that it should be taken while they were prosperous. Nigel Law told Sargent that the feeling in the City was more anti-German than he had ever known it; it was held, especially in Bank of England circles, that the time was approaching when the Standstill should be brought to an end. A representative of one of the largest private banks in Germany had told Law that of the £35 million in British credits outstanding, £25 million was really being used as working capital by German firms. Law noted that one of the repercussions of this City attitude, "had been severely to curtail the activities of Mr. F. Tiarks.. who is now regarded as having been in the past too easily won over to the German point of view and too fond of presenting his colleagues with a fait accompli". Lidbury of the Westminster Bank was brought in to lead the negotiations. A further repercussion was a refusal by the "two banks most interested in the question" to grant fresh credits outside the Standstill.<sup>73</sup>

The Treasury did not want to commit itself in advance of any situation, especially as the position seemed to be such a difficult one. As far as the Payments Agreement was concerned, there was satisfaction that it had worked well and the Treasury did not want to take any measures which might

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72. T 160 818 12681/05/4, note of meeting 11 Jan. 1937.

73. FO 20724 C627, letter, 22 Jan. 1937.

imperil British trade and start a fresh quarrel with Germany. It was admitted, however, that since the frozen trade debts had been paid off, some £3 million had been made available to Germany to help her in rearming. Creditors, meanwhile, had received no repayment and holders of non-Reich loans, for example, had to accept 4 per cent interest not in cash but in Funding Bonds. So, as Waley saw it,

"The German exchange position is so difficult that it is very unlikely that they will offer satisfactory terms to the British creditors unless we use threats and it is very undesirable to start using threats when we are most unwilling to carry them out. One can only hope that Mr. Governor's influence with the Germans on the one hand and with the British creditors on the other will enable some satisfactory agreement to be reached with a minimum of alarms and excursions".<sup>74</sup>

There was a further dimension to the problem. Pinsent reported from Berlin in early February that Tiarks had interpreted the moves of the clearing banks as a kind of revolt against his leadership, although things had been temporarily smoothed over. But Pinsent opined that attempts to breakdown the Standstill would weaken Schacht's position - he was, of course, held to be one of the 'moderates' in the Nazi leadership - and that until Britain was prepared to face this consequence, any moves were inadvisable. Pinsent also suggested that those who talked about German rearmament could be answered by reference to the fact that Germany had sacrificed her foreign exchange receipts from tourists.<sup>75</sup>

The Treasury records include an intriguing memorandum which, although unsigned, seems to have originated outside Whitehall. It argued that the Standstill creditors would be advised to stick together as otherwise they stood to lose their benefits, which were greater than those of others. In their wish to keep the international banking machine running, the British banks had maintained their credits to Germany to finance international trade. If the banks withdrew the services of the London market from German banks and industry, a severe blow would be struck at what remained of Germany's international trade. The author of this document thought that there was little reason to continue to allow Germany to enjoy the benefits of the liberal British exchange policy if she did not take up the political offers that had been made (by Eden), as Britain would be continuing to finance German rearmament. If the German response was negative it was up to the Government to use the Standstill as an instrument of policy against Germany. For she would never make repayments unless from the 10 per cent allocation of the Payments Agreement. <sup>76</sup>

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74. *ibid.* min. by SDW to Phillips and Hopkins, 14 Jan. 1937.



As the negotiations for the 1937 renewal of the Standstill were about to begin, Leith-Ross was told by Arthur Guinness that the clearing banks had come forward with a demand that there should be a 10 per cent repayment, otherwise they would only consent to a temporary agreement to give warning that Britain intended to break away from the international Standstill. 77

In reality the banks were perhaps a little less sanguine. In the diary of Hyde (Chief General Manager of the Midland), there is a record of a conversation with Lidbury about the line the latter was to take at the Berlin conversations. Hyde wrote, "The point I thought we ought to get recognised was that some reduction was overdue and we should welcome any move in this direction". It was hoped that there might be a 5 per cent reduction in the amount of the original Standstill. 78

Indeed, the delegates intended to ask for 10 per cent but were prepared to accept 5 per cent. Yet when Schacht offered nothing the delegates recommended acceptance. In the middle of the negotiations Brand and Lidbury returned briefly to London. Failing to see the Chancellor, they pressed their claim on Leith-Ross that in any revision of the Payments Agreement they wished to be free to receive benefits in much the same way as the French had been allowed to get their Standstill credits repaid in coal. 79

The views of the German authorities were set forth in a memorandum presented to the Standstill conference. During 1936 the rise of German business activity had intensified and surpassed the peak of industrial production attained in 1928-9. Profits had improved, imports had been reduced and exports had shown a 15 per cent increase in volume over the year, but at a cost of price cutting which involved heavy exchange losses. Of the export surplus of Rm 550 million only about 20 per cent was at Germany's free disposal in Devisen whereas about 80 per cent was tied up by clearing arrangements of one kind or another. The 20 per cent was insufficient to meet the interest liabilities under the German Credit Agreement. Of the Rm 268 million decrease in the volume of credit lines during the first nine months of 1936, about Rm 257 million was repaid in Register marks.

It was appreciated that the liquidation of German debts by the utilisation of such facilities for travel purposes necessitated financial loss to foreign creditors. But, it was pointed out, it had also meant a heavy sacrifice for the Reichsbank's foreign exchange situation. In order to bridge the period of time between Devisen requirements and Devisen influx, a broad-minded maintenance of the remaining open credit lines was, therefore, considered an absolute necessity. 80

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75. *ibid.* Pinsent to SDW, 18 Jan. 1937.

The international creditors remained broad-minded; the German case prevailed. Pinsent, for one, did not think the time was right to make an all-out attack on the German position. But he speculated that the demonstration might have done some good and in all events Tiarks thought it would satisfy McKenna. Pinsent had pointed out to the delegates the strong position enjoyed by the City; he doubted whether this position would be strengthened by bringing in the Government.

But Pinsent found Lidbury "very unsatisfactory". The latter would only make fire-eating remarks to the effect that the Germans were working a continuous swindle, that the quality of the Standstill bills was steadily deteriorating, and that he would rather see a clearing imposed than to receive no cash. Lastly, Lidbury assumed that the Government would not let the City down. Pinsent thought that he should voice his feeling that, "it would be curious, after the Standstill creditors had been so violently opposed to a clearing in the interests of others, that they should demand one in their own interest." Waley, however, was sceptical: events could yet show Pinsent was on the optimistic side in believing that better terms for creditors could be obtained in the future. The Government would have to make up its mind how far to support both the bondholders and the Standstill people. But, Waley added ruefully, there were, of course, a great many other and much wider questions about Germany in regard of which the Government apparently still had to make up its mind.<sup>81</sup>

At the time of the Standstill renewal, Britain's outstanding availments amounted to £43 million or 50 per cent of the total outstanding.<sup>82</sup> One particular City firm called Dreyfus appeared to be very heavily involved. Its problems were discussed at a bankers' meeting in June. The firm was said to have credit lines (acceptances and cash advances) in the Standstill amounting to some £10 million. Co-operative action by the banks themselves to ascertain the position of Dreyfus was opposed, notably by McKenna; instead it was agreed that Lord Wardington (Lloyds Bank) should enlist Norman's help.<sup>83</sup>

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76. *ibid.* 16 Jan. 1937.

77. T 160 818 12681/05/4, note by FLR, 5 Feb. 1937.

78. MB 30/99, Hyde's Diary, 2 Feb. 1937.

79. T 160 818 12681/05/4, Pinsent to SDW, 10 Feb. 1937 and note by FLR, 15 Feb. 1937.

80. MB 30/190, German Committee Memorandum, February 1937.

81. T 160 818 12681/05/4, Pinsent to SDW, 22 Feb. 1937, SDW to Pinsent, 4 March 1937.

82. BE 0V34/138, note by Gunston, 31 May 1937.

83. *ibid.* note by Peppiat for Governors, 4 June 1937.

In these circumstances, the idea of splitting up the Standstill into national, as opposed to international, agreements was again raised. Schacht was seemingly prepared for this and the British committee was not opposed. Stopford, the Joint Committee's secretary, did not think that Britain should take a percentage on the Payments Agreement if the Standstill was ended. Rather he believed that the British Government should have a clause inserted in the Payments Agreement to the effect that if the Germans failed to carry out their agreement with the British creditors, then the latter would come into the Payments Agreement.<sup>84</sup>

Throughout 1937 the London creditors considered whether to ask for Government support for increased cash payments. At the same time they did not want to press their claims if Schacht's position appeared to be weak. Creditors also began to refer to the 'recommercialisation' of the Standstill. A distinction was drawn between 'commercial' bills on the one hand and other bills and cash advances on the other, each accounting for about half the world total. Commercial bills were subdivided into 1) bills drawn on unused credit lines for financing international trade, regarded as the best type of Standstill bills; 2) bills eligible for rediscount at the Central Bank of the creditor centre; 3) bills not eligible for discount at a Central Bank but drawn in connection with German imports or exports. It was believed that one advantage of recommercialisation was that if London held its claims on Germany in the form of commercial bills, it would be in a good position after the Standstill had ended to retain the financing of Germany's external trade.<sup>85</sup>

At a meeting of the Joint Committee in October McKenna at first declared that he was opposed to any agreement without repayment and that he wished to appeal immediately to the Government for support. Brand pointed out that the Government was very unwilling to give such support and wondered whether it would not be wiser for the Committee to keep appeals in reserve in case the Standstill broke down and they found themselves in a worse position. Any premature action might have prejudiced their position in asking for help at a later more crucial stage, when a request was more strongly justified. These arguments impressed McKenna.<sup>86</sup>

In November Leith-Ross did seriously question whether the Payments Agreement should not be opened to secure perhaps £3 million for a Sinking Fund to be distributed equitably between the various claimants. Leith-Ross felt inclined to press for capital payments as the Germans had shown so little appreciation of British efforts to help them. Yet he realised that a decision needed to be taken at a higher level as to whether the political conditions were appropriate for such negotiations.<sup>87</sup>

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84. *ibid.* note, 10 May 1937.

As part of the continuing round of negotiations between Standstill creditors and Germany, Tiarks once again raised the issue of capital repayment in talks with Schacht in late 1937. Tiarks pointed out that under the original Standstill Agreement the Golddiskontbank had agreed to guarantee 10 per cent of the bills of each creditor. But payments under this guarantee had been suspended in 1933. Tiarks wanted the 1933 payments paid in 1938. Schacht disapproved and simply said Tiarks should see Göring. This timely reminder of the difficulties facing Germany as a whole and Schacht in particular was sufficient to deter the U.K. creditors, once again, from pressing their claims.<sup>88</sup> Yet, at the same time, Tiarks told the Acceptance Houses Committee that he thought Schacht's position in Germany was better than it had ever been.<sup>89</sup>

Waley estimated that the total British financial claims on Germany at this time amounted to £135 million. The Standstill accounted for £44 million, Dawes and Young £26 million, non-Reich loans £21 million, states and rents £37 million, and Funding Bonds £7 million. Waley also calculated the effect of including the Standstill in the Anglo-German balance of payments for the year ending September 1937.<sup>90</sup>

	£ million
U.K. imports from Germany .. .. .	32.294
U.K. exports to Germany .. .. .	21.375
	<u>13.919</u>
Required for Standstill and other loans .. .. .	4.100
	<u>9.819</u>
Required for re-exports .. .. .	7.093
	<u>2.726</u>
Maximum available for non-Reich loans or increased payments on Standstill.. .. .	2.726

After the preparatory talks with Schacht in Berlin, the negotiations for the 1938 renewal of the Standstill were held in London in December 1937. The conference heard from the German committee how under the substantial expansion

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85. *ibid.* note by Gunston, 22 Sept. 1937.

86. *ibid.* record of meeting, 20 Oct. 1937.

87. T 160 818 12681/05/5, Memo. FLR to SDW, 3 Nov. 1937.

88. *ibid.* Memo. SDW to FLR, 4 Nov. 1937.

89. Brand Papers, File 193, record of meeting on 4 Nov. 1937.

90. T 160 759 14466/1, Waley's estimates based on Memo. by Lever of Prudential.

of Germany's foreign trade, the foreign credits still left to the German economy -47- were all the more urgently required for the future. This increase in the volume of trade offered, at the same time, an opportunity to provide for its financing on a gradually increasing scale in the shape of bills drawn under the Standstill. This idea had found expression in the plan for the re-commercialisation of existing lines.<sup>91</sup>

In these circumstances and in response to the difficulties surrounding Anglo-German relations the British Bankers' Association passed the resolution that no new credits should be granted for financing German business which could be financed by means of Standstill lines. An exception was made for the British Overseas Bank which for many years had been in the habit of financing German imports by means of credits; there was no intention to interfere with business of this kind. It was particularly requested that this resolution be regarded as confidential and precautions taken to ensure that it did not reach the press.<sup>92</sup>

At the conference a new scheme was introduced to cover credit lines under the 1938 Agreement. Credit lines were only to be availed of by bills drawn for financing international trade and not for the purpose of creating foreign exchange or financing international business. A large proportion of Germany's foreign trade, of course, fell under clearing agreements and was thus automatically removed from the sphere of banking credits.

#### iv) The Standstill and the Coming of War.

As Schacht's influence in Nazi circles declined and Hitler started down the path of annexation in Europe, so the Standstill negotiation became even more difficult and confused. Prior to 1938 problems had been mitigated, to some extent, by the close relationship between Schacht and Norman, though the latter had to contend with political charges that the City was lending afresh to Germany.<sup>93</sup>

However, it is not entirely certain that British credit was not still being extended to Germany outside the Standstill. A Bank of England memorandum explained in detail how the recommercialisation of Standstill credit worked in practice. In the case of credits granted for exports from Germany, recommercialisation did not involve the Reichsbank in any extra commitment in terms of Devisen. But this was not the case with import credits. For example, A (a London bank) had a fully utilised Standstill credit line of £1000 to B (in Berlin). B was willing and able to repay the whole of this in Reichsmarks. The

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91. MB 30/190, German Memo. to Standstill Conference, 1937.

92. *ibid.* extract from minutes of British Bankers' Association committee meeting, 9 Dec. 1937.

Reichsbank, having obtained an undertaking from A to extend a further credit of £1000 to C (in Bremen) - who wished to import coal from the U.K. - placed £1000 in Devisen at the disposal of B for the purpose of repaying A. A then opened a new credit of £1000 in favour of C, which was drawn upon the British exporter. The Reichsbank therefore paid away £1000 immediately. Had the recommercialisation procedure not been adopted, the Reichsbank would have been able to make good this loss of exchange with a Renewal Bill for £1000. The British exporter would then have had to arrange his own financing and the Reichsbank would only have had to provide the £1000 at the ordinary commercial usance, namely three months later. In other words, the document concluded, with recommercialisation the Reichsbank had to put up Devisen three months earlier than it would have were the transaction financed by means of a non-Standstill credit in London.<sup>94</sup>

A few days after the new Standstill agreement came into effect, (and just before the Anschluss), the Government indicated to the City that in view of the terms of the renewal and the expressed desire for recommercialisation of the credits, it was undesirable to give any credits outside the Standstill.<sup>95</sup> The inference is that there was a practice of giving such credits. The Bank of England instructed its employees that information on the confidential subject of short-term credits to Germany outside the Standstill was not to be passed to any person inside or outside the Bank without the consent of the Discount Office.<sup>96</sup>

With the problems between Britain and Germany over Austrian debt payments in mid 1938, the position of the Standstill was once again endangered. (See Chapter VIII). Towards the end of the year Waley noted that the British creditors wanted to come out of the Standstill. He recalled how in January 1937 they had tried to obtain, through the Treasury and Board of Trade, full Government support for their claim for better terms. Some improvement had been achieved in placing credits on a more truly commercial and liquid basis. With Britain threatening to impose a clearing on Germany in June 1938, the creditors probably came to realize the difficulty of their position being party to an international agreement and so not being able to enjoy a free hand to claim the Government's protection in the event of a separate agreement.

Waley believed, however, that it would not be only the Germans and Americans who would dislike a separate agreement: the British Government would also have been most reluctant to have denounced the existing agreement in order to obtain better terms for the creditors. It suited the Government to leave matters undisturbed. Although the Treasury could not stop the creditors from taking any such

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93. Sayers, Bank of England, p.511.

94. BE OV34/140.

95. MB 30/190, Memo. 4 March 1938.

96. BE OV34/139.



action, it could be made plain to them that they could not expect Government support.<sup>97</sup>

A memorandum in the Midland Bank archives echoes Waley's opinions. It was felt that there was no point in having an international agreement. The suggestion was that the delicacy of the relationship between Britain and Germany would probably render it wise for British banking creditors to advise the Government or Bank of England of their point of view, before committing themselves to a renewal of the Standstill. This would be all the more necessary if British banking creditors wanted to rely at some future date upon action taken by the Government to secure service and amortisation of debts under the Anglo-German Payments Agreement.<sup>98</sup>

Throughout 1938 the Bank of England monitored the distribution of Standstill bills in the market in order to deal with the implications of the continuing illiquidity of the bills. The clearing banks had become reluctant to take them as security and had thereby forced up the rates of discount at which they changed hands. The high rates had tempted some of the smaller discount houses, which appeared to hold amounts dangerously large in relation to their own capital resources. Apparently, the Bank of England even considered taking over two thirds of the accepting houses' remaining obligations. In February 1939 Norman asked the clearing banks not to refuse to take Standstill bills as security for loans in the market, but only to use the rates to discriminate against them. This helped to keep the market in the bills alive while the agreement was being renegotiated.<sup>99</sup>

In June 1939 the Bank of England informed the clearing banks that the Governor had written to the acceptance houses asking them to reduce, in the following six months, the volume of their acceptances of Standstill bills on the market by 40 per cent.<sup>100</sup> The Discount Office of the Bank of England had first written to Kleinworts, for example, in April 1937, to request a reduction in their bills by 30 per cent to £3,461,000. In 1939 they wrote again to request a further reduction of £1,485,000. By the outbreak of war, £4.5 million was still owed to Kleinworts - approximately half of the total commitments of the firm frozen under the Standstill agreements with Germany, Austria and Hungary.<sup>101</sup>

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97. T 160 818 12681/05/5, SDW Memo. 14 Nov. 1938.

98. MB 30/190, Memo. 9 Nov. 1938.

99. Sayers, Bank of England, p.511.

100. MB 30/190, extract from minutes of meeting of Committee of London Clearing Bankers, 1 June 1939.

101. Diaper, 'History of Kleinwort', p.228-9.

At the end of March 1939 the short-term creditors wrote to Montagu Norman about the problems surrounding the Standstill. Their memorandum pointed out that although credits had been generally of a self-liquidating nature, as Germany's foreign trade had progressively fallen off, so an increasing per-centage of the credits had not been employed for financing movement of goods but had been utilised as working capital in Germany. This was contrary to the wishes of the banking institutions who were, however, powerless in the matter.

The memorandum claimed that in the yearly renewals creditors had attempted to get the Germans to repay the credits which were not used to finance import/export trade and to increase the utilisation of credits for financing genuine import/export transactions. It had been understood that the German debtors had been prepared to go a long way towards this. Of the £36 million still outstanding, £20 million was carried in the form of bills. But, bills drawn under the Standstill were becoming increasingly unacceptable to the discount market and particularly those bills which were not drawn against the movement of goods. The conclusion was that an increasing number of bills would have to be taken up for cash, depriving the market of perhaps £10 million, and requiring banks and acceptance houses to provide a corresponding amount of cash in a short period.

The bankers firstly wanted an assurance that such moves would not be inconsistent with Government policy and that they were right to assume that they could rely upon the support of the Government in negotiating along these lines. Secondly, they wanted to know whether their interests would be protected if negotiations broke down. The Chancellor replied to Catterns, the Deputy Governor, with an affirmative to the first question; but he would not commit himself with regard to the second.<sup>102</sup>

By 1939, therefore, the creditors were in an intractable position. In the Midland Bank it was felt that although the Standstill situation was highly unsatisfactory, a determination would make matters worse. What had to be considered was the "official flavour" which from the outset had coloured the Standstill - the original decision to extend credit to Germany in 1931 and the international co-operation to avoid discrimination - if one creditor nation or group contemplated leaving the agreement.<sup>103</sup>

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102. MB 30/190, Memo. and letter of Joint Committee, 31 March 1939.

103. *ibid.* Internal Memo. 14 April 1939.



Lidbury visited the Midland to discuss what could be done about the £36 million outstanding to British creditors, (two thirds to the acceptance houses, one third to the banks). An emphatic McKenna attempted to impress upon a doubting Lidbury that the Midland, at least, would not go on with the Standstill unless there was a 10 per cent reduction. Lidbury was asked to pass this message on to Tiarks in very definite terms.<sup>104</sup>

In the negotiations for the renewal of the agreement from the end of May 1939, the Germans wanted the creditors to maintain lines, which were to be recommercialised, for three years. Although Lord Wardington of Lloyds Bank was not disposed to so do, the other three clearing banks agreed. But as for the other German proposals, the Midland described them as "barefaced effrontery" and Lidbury considered them "monstrous". Even the pretence of mere postponement of fulfilment of obligations, which had been the sentiment of former agreements, was seemingly abandoned in the new scheme. Instead of a short-term freeze, the creditors were offered the "North Pole", for a period of which the end was nowhere in sight.<sup>105</sup>

However, although the banks insisted that the Germans should make a substantial cash repayment, the acceptance houses at first disagreed strongly: they felt inclined to accept the German proposals. Finally all the British creditors agreed that, unless the Germans made some acceptable cash payment within six months, they would put an end to the Standstill. If the Germans intended to make such an offer, then the British creditors were prepared to discuss the possibility of allowing creditors the option to contract out of the Standstill and grant fresh credits to Germany outside it. Under the May renewal there was some reduction of indebtedness and further provision was made for cancellation of unavailed credit lines.<sup>106</sup>

Some weeks later the detailed regulations on the provisions of the new Standstill Agreement for the sale of Register marks reached the City. The Financial News reported deridingly that it took some time before foreign exchange departments were able to ascertain exactly what the new regulations meant. One of the London banks offered a prize to anyone capable of producing an intelligible English translation. When at last the regulations were understood, foreign exchange dealers were amazed at the ingenuity spent on obscuring the true meaning of the new system.<sup>107</sup>

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104. *ibid.* extract from Astbury's Diary, 19 April 1939.

105. *ibid.* undated Memo. of conversation Lidbury/McKenna, and note, 27 April 1939.

106. BE OV34/140, notes by Gunston, 28 April 1939 and May 1939.

107. Financial News, 25 May 1939.

The Joint Committee wrote to the chairman of the Committee of London Clearing Banks regarding a secret letter of 30 November 1937, on the subject of the mutual agreement not to grant further credits of any kind to Germany for any purpose which could be achieved by use of Standstill lines - the resolution passed by the British Bankers Association. The instruction was to remain in force.<sup>108</sup>

The British Government continued to reject any ideas of giving help to the short-term creditors. In a Treasury memorandum Waley set his face against any change. Unless the Board of Trade had changed its view, Britain should continue to refuse to denounce the Payments Agreement. Renunciation would not make the Germans any more co-operative. The Government could, of course, denounce the Payments Agreement on the grounds that it was contrary to Britain's interests to afford Germany the means to buy potential war materials in Britain and free exchange to buy raw materials from the British Empire. But Waley did not think that the Treasury would wish to provoke such a discussion at that moment.<sup>109</sup>

As the likelihood of war in Europe increased, so creditors had to make plans to determine the Standstill Agreement. This, it was realised, could be effected by Britain and America as they held some 75 per cent in face value of credit lines then outstanding. There was already in the U.S., as in London, a reluctance on the part of banks to increase their German commitments by the acceptance of fresh bills and the American committee were anxious that if hostilities broke out in Europe, the Agreement should be legally determined with the shortest possible delay. If it was not, and no legislation was passed in the U.S. to prohibit the further acceptance of bills for German account, the American banks would be liable to continue their acceptances or run the risk of legal action by the German debtors, as was the case after the 1914-18 war.<sup>110</sup> Thus the British Joint Committee resolved to determine the Agreement, in the event of hostilities, through the agency of the American creditors. A cable to this effect was duly sent to the U.S. on 2 September, and the next day the American Bankers Committee determined the Standstill Agreement.<sup>111</sup>

By the middle of September, the Financial Times suggested that creditors were playing a game of hide and seek; both British and American creditors were busy finding the whereabouts of cargoes in respect of which Standstill bills were drawn. American institutions sequestered about £5 million of German gold securities. It was also reported that the termination of the Agreement had not

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108. MB 30/190, letter undated.

109. T 160 818 12681/05/5.

110. MB 30/190, Memo. 25 Aug. 1939.

111. *ibid.* Joint Committee Resolution, 25 Aug. 1939.

unduly strained the British acceptance houses.<sup>112</sup> The 1931-9 era of Standstill Agreements can be said to have closed when Lord Wardington, now Chairman of the Joint Committee, wrote to the office of the Public Trustee with the information that £34 million was owed to Britain at the outbreak of war. He seems to have attempted to justify this position by referring to how payment through, for example, Travel marks which sold at a large discount, had involved creditors in heavy losses.<sup>113</sup>

TABLE 4  
Total returns of British Banks and Acceptance Houses  
under the German Standstill Agreements.<sup>114</sup>

Credit Lines (and Availments) in £ million.			
Date	German Banks	German commercial and industrial	Total
31.7.31.	46.1	18.6	64.7
30.9.32.	43.1 (36.3)	16.5 (14.0)	59.6 (50.3)
31.11.32.	42.4 (35.6)	15.9 (13.4)	58.3 (49.0)
1.3.33.	39.3 (32.9)	14.8 (12.5)	54.1 (45.4)
15.12.33.	39.0 (31.6)	15.0 (12.1)	54.0 (43.7)
31.12.34.	36.3 (31.0)	13.9 (10.4)	50.2 (41.4)
31.12.35.	36.5 (33.6)	12.7 (10.0)	49.2 (43.6)
31.12.36.	34.0 (31.7)	11.8 (9.4)	45.8 (41.1)
1.11.37.	31.6 (30.4)	10.2 (8.8)	41.8 (39.2)
31.8.38.	30.1 (28.9)	8.1 (7.4)	38.2 (36.3)
28.2.39.	28.4 (27.3)	7.7 (6.8)	36.1 (34.1)

112. *ibid.* Financial Times, 14 Sept. 1939.

113. *ibid.* letter, 26 Sept. 1939.

114. Compiled from BE OV/34/131, 133 and MB 30/190.

TABLE 5  
Comparison of Total Credit Lines under the German  
Standstill Agreements †15.

Reichsmark millions			
Date	United States	Britain	Total for all countries
15.7.31.	1629	1051	4390
31.3.33.	1698	892	3841
30.9.33 } rates at	1440	825	
28.2.34 } 28.2.33.	1196	826	
28.2.34.	715	724	2528
30.9.34.	569	660	2140
28.2.35.	511	613	1961
30.9.35.	432	602	1644
28.2.36.	416	611	1567
30.9.36. - rates at 29.2.36.	343	582	1330
28.2.37.	333	561	1165
28.2.38.	249	518	970
28.2.39.	203	463	806

TABLE 6  
Per-centage Share by Country of Total Credit Lines  
Under The German Standstill Agreements 116

Country	8 Oct. 1931	30 Sep. 1937	28 Feb. 1939
United States	36.2	26.7	26.4
Britain	28.2	52.3	56.3
Switzerland	16.0	10.1	8.7
Holland	13.0	7.2	6.7
France	4.5	1.1	0.7
Belgium and others	2.1	2.6	1.2

115. Compiled from BE OV34/133,135,137-9,147,190.

116. Compiled from MB 30/190, German Memoranda to Standstill Conferences, Dec. 1937, and May 1939.

TABLE 7Some Members of the Joint Committee of British Short-Term Creditors in 1933. 117

Brand, The Hon R.H.,	Lazard Bros. & Co. Ltd.,
Caulcutt, Sir J.,	Barclays Bank Ltd.,
Goschen, Sir H., *	National Provincial Bank Ltd.,
Guinness, A.,	Guinness, Mahon & Co.,
Hambro, R.O.,	Hambros Bank Ltd.,
Holland-Martin, R.,	Martins Bank Ltd.,
Lever, E.H.,	Prudential Assurance Co.,
Beaumont Pease, J.W., *	Lloyds Bank Ltd.,
Rothschild, A. de,	New Court,
Tiarks, F.C. & H.F.,	J. Henry Schröder & Co..

\* = Joint Chairman.

F.C. Tiarks was also Chairman of Joint Committee of Representatives of Foreign Bankers' Committee (of Germany), and Brand was a member.

### CHAPTER III

#### British Policy towards Germany in the Hoover Year.

In 1931-2, the year of the Hoover Moratorium, there was a succession of events of fundamental political and economic significance. The consequences of, for example, Britain's departure from the Gold Standard, the establishment of tariffs and Imperial Preference, and the attempts to find a solution to the problem of war debts and Reparations, helped to form the course of history in the 1930s. This chapter will attempt to examine British policy towards Germany, from a financial and economic view point, in the period from the international financial crisis in the summer of 1931 to the Lausanne Conference in the summer of 1932.

It is, perhaps, to the experiences of 1931-2 that one must look in order to understand some aspects of policy-making later in the decade. The events of the Hoover Year helped to set the psychological framework in which British economic policy was carried out long past the time when, with the coming of National Socialism in Germany, new approaches were needed. But for the purposes of this chapter it is important to try to analyse what ministers and their advisers hoped to achieve by their policy towards Germany. In particular, were they motivated largely by attempts to win economic gains for Britain, of either the short or long-term kind, or did they fully realise how British financial and economic policy might influence political developments in Germany? If the dangers of National Socialism were recognised it also has to be asked whether those responsible for policy were imbued with a sense of urgency as the Nazi party began to make big advances in the German elections from 1930.

#### i) Britain's Departure from the Gold Standard.

On 7 June 1931 the German Chancellor, Dr. Brüning, and Curtius, the Foreign Minister, visited Britain. Talks were held at Chequers with British ministers and high officials in preparation for the inter-governmental conference which was to be held in London in July. Brüning recorded in his Memoiren that Vansittart was stiff but that Sir Frederick Leith-Ross was almost friendly.<sup>1</sup> At Chequers Montagu Norman warned the Germans of the impending Austrian financial crisis.<sup>2</sup>

Yet, even by the end of May 1931 Austrian difficulties had begun to affect Germany. The latter country experienced heavy capital withdrawals in June.<sup>3</sup>

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1. H. Brüning, Memoiren 1918-34 (Stuttgart, 1970), p. 337.

2. CAB 24/222, CP157.

On 20 June the Hoover Moratorium was announced, but its proposal to suspend all inter-governmental debts met initial resistance from the French Government. The Central Bank credit to Germany for \$100 million, arranged on 25 June, was used up by 5 July. The next day the Hoover Moratorium finally came into effect. But these measures could not prevent further disastrous runs on German reserves. When the news reached London on 13 July that the Reichsbank's legal reserve was all but exhausted and that the Bank of England had been approached for emergency credits, there was a feeling in the Foreign Office that Germany had brought the difficulties on herself. The Assistant Secretary, Sargent, even believed that Germany was manufacturing a political crisis. The next day the Darmstädter and Nationalbank closed its doors.<sup>4</sup>

Sargent was kept informed of the attitude of the City to Germany by his colleague Nigel Law. The idea of a long-term loan to Germany was not favoured by most financiers. Instead, it was held that what Germany needed was a large or even unlimited credit granted to the Reichsbank, middle-term loans for individual banks, and a continuation of short-term loans and acceptances. The purpose of all these would be to restore confidence.

Law believed that the political considerations which made "Hitlerism" more probable would keep away from Germany far more money than the largest conceivable political loan could bring her. He also subscribed to the view that the German Government had planned the crisis for early July when the American Secretary of State Stimson would be in Europe. German declarations of bankruptcy before the discussions at Chequers were taken to be a smoke-screen, and it was thought that a definite German plan to escape Reparations had only got out of hand with the collapse of the Creditanstalt. Law claimed that while the French looked only on the plot and declared that Germany could not be allowed to get away with it, Britain pointed out that the world could not be saved and Germany punished at the same time; the former was vital however just the latter might have been.<sup>5</sup> The Foreign Office was in sympathy with these views. The result was that attitudes towards Germany were ambivalent. German claims that some time before the end of the Hoover Year the question of Reparations and debts would have to be settled on a new basis were, at this stage, treated with caution.<sup>6</sup>

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3. S.V.O. Clarke, Central Bank Co-operation:1924-31 (New York,1967),pp.186-9; Kindleberger, World in Depression,p.157; H. James, 'The Causes of the German Banking Crisis of 1931', Economic History Review,XXXVII(1984);K.E. Born, Die deutsche Bankenkrise 1931(München,1967).

4. FO 15210.

5. *ibid.*

6. FO 15211.

At the London Conference of 20 July 1931, Luther was unable to win support for the idea of a new Central Bank loan, but the \$100 million loan already advanced was renewed for a further three months. Private creditors were asked not to withdraw loans from Germany. Two months later this arrangement was formalised under the Standstill Agreement. Another recommendation of the conference was that Germany's problems should be investigated by a special committee of experts. Under the auspices of the BIS the Wiggins-Layton Committee was formed to enquire into the immediate further credit needs of Germany and to study the possibility of converting a portion of the short-term credits into long-term ones. A report was produced by mid August.<sup>7</sup>

Hopkins, the Treasury official, noted for the benefit of Prime Minister MacDonald that the report did not carry them much further: the ball had been passed back to the Governments. There was, at least, a very authoritative pronouncement that Reparations lay at the root of the problem. The report also suggested that if severe economic effects were to be avoided, it was necessary that some of the capital withdrawn from Germany should be replaced from foreign sources, not in the form of short-term credits which would only increase Germany's difficulties, but by a long-term loan. Germany's credit was not good enough to justify such action, so there was an urgent need to restore confidence. Hopkins thought that the report treated the fundamental question of Reparations and debts in a veiled and cautious manner. Yet this point could not have caused much surprise in view of the failure of the Allied Governments to agree to a common approach to the problem.<sup>8</sup>

During the summer of 1931 the financial crisis spread to London. The difficulty of withdrawing money from Germany aroused in its turn distrust of the position of those financial institutions which were known to be important short-term creditors of Germany. Money was withdrawn from other centres, notably from London.<sup>9</sup> Some countries, especially those who were on the Gold Exchange Standard and who had small gold reserves, kept a buffer stock of claims on foreign currencies, particularly the dollar and sterling. But London had never acquired reserves necessary to meet the abnormal strains imposed on the international exchange system in 1931.<sup>10</sup>

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7. The Times, 20 Aug. 1931.

8. T 188 23, 22 Aug. 1931.

9. Henderson, Inter-War Years, p.99.

10. Lewis, Economic Survey, p.158; L.B. Yeager, International Monetary Relations (New York, 1966), p.335.



In the second half of July the Bank of England lost \$200 million in capital flight. On 23 July the Bank increased the discount rate from 2.5 per cent to 3.5 per cent, and by September it had risen to 6 per cent. Yet neither this nor the formation of a National Government stopped further withdrawals. On 21 September Britain left the Gold(Bullion) Standard; the intention was that the departure would be a temporary one for six months.<sup>11</sup>

Consideration of the effects of this action on other countries seems to have come after the decision had been taken. Sir Ernest Harvey, Deputy Governor of the Bank of England, indicated why this might have been so. He wrote to Luther, the Reichsbank President, that, "It cannot have been easy to appreciate from published accounts of what happened last week how suddenly we were faced with the necessity of suspension. Nothing could be more disturbing and distasteful to us than that Central Banks should suffer as a result of their association with the Bank of England." Harvey left it to Luther's discretion to decide whether to withdraw Reichsbank funds from the Bank. But, Harvey commented, up to that time there had been practically no Central Bank withdrawals. The Bank of England had always tried to maintain relations of mutual confidence with all its Central Bank clients based upon the idea that they might be relied upon to stand together in all circumstances. While Harvey appreciated that normal banking relationships might be interrupted or curtailed for a time, he hoped that the day would come when they would be able to continue their co-operation on the stable basis which the Gold Standard alone could provide.<sup>12</sup>

It is doubtful, however, whether all Central Banks saw London's actions in such a favourable light. For it was not long before the Banks of Belgium and France withdrew large amounts of funds from the Bank of England. But in replying to the Governor, Luther wished to convey his warm and sincere sympathy. He regarded it as tragic that the assistance which the Bank of England had generously and unhesitatingly afforded to the Reichsbank and other Central Banks in their hour of need had increased the difficulties with which London had had to contend. The Reichsbank would "not forget what the Bank of England and what you, dear Mr. Governor, have done for the co-operation of Central Banks. In a time of general disturbance and danger I derive the greatest comfort from the sincere friendship existing between our two Institutions."<sup>13</sup>

There are contemporary reports which claim that Siepmann (Adviser to the Governors), asked the Reichsbank on 20 September to follow Britain off Gold.<sup>14</sup> Yet there is nothing in the correspondence between the two Banks which is available.

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11. Kindleberger, World in Depression, p.159; S. Howson, Domestic Monetary Management in Britain 1919-38 (Cambridge, 1975), pp.75-82.

12. BE OV34/81, 28 Sept. 1931.

13. *ibid.* 6 Oct. 1931.

to suggest that the Reichsbank were encouraged to act in any particular direction. British officials received a report from the Berlin Embassy on 28 September which pointed out that people in Germany confused inflation and devaluation and that they therefore would or could not follow Britain off Gold.<sup>15</sup> The British devaluation was regarded by Brüning and Luther as inflationary and dangerous and it was this, rather than the constraints of the Young Plan or pressure from France, which deterred the German Government from following Britain.<sup>16</sup>

It was immediately recognised in London, though, that movements in the exchange rates would pose new problems for Germany. Leith-Ross commented that Britain's action had helped Germany in one way: a proportionate reduction had been made in the burden of all Germany's sterling debts. But against this there was the danger that Britain (and countries like Sweden), would soon be in a position to cut export prices and make the trade position of Germany much less comfortable. The question was one, therefore, of how long Germany would be able to stay on Gold before she faced economic collapse. For this reason she would have to follow Britain off Gold in the long run but, as Leith-Ross wrote, "the longer they can keep themselves on the Gold Standard so much the better for our exports".<sup>17</sup> In a letter to Henderson, Brand noted that the advantages Britain was getting out of the depreciation of sterling might be dearly bought by the additional knocks given to Germany in particular.<sup>18</sup>

In the aftermath of Britain's suspension of Gold, the top Treasury officials Sir Warren Fisher and Sir Richard Hopkins attempted to lay down policy guidelines in a secret memorandum which survives among the private papers of the Chancellor of the Exchequer, Neville Chamberlain. They felt that it was easy enough to advocate international conferences on debts, Reparations, and on gold policy, but that before such a conference could do any good there had to be some prospect that the United States and France had the same objectives as Britain. Until this was the case, any conference was foredoomed to failure and would almost certainly accentuate the difficulties. In view of the failure of the World Economic Conference in 1933, and the achievement of the Tripartite Agreement in 1936, such words were indeed prophetic.<sup>19</sup>

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14. James, 'The Reichsbank', p.298.

15. FO 15211.

16. Kindleberger, World in Depression, p.163. See also K. Borchardt, 'Could and Should Germany have followed Great Britain in leaving the Gold Standard?', Journal of European Economic History, Vol.13, No.3 (1984), pp.447-9. Borchardt concludes that there was no political pressure put on Germany by Britain to follow the latter off Gold.

17. FO 15211, FLR to Rowe-Dutton, 28 Sept. 1931, and to Sargent, 30 Sept. 1931.

18. Brand papers, File 112, 29 Oct. 1931.

The countries which had been through the process of inflation were seen as being firmly resolved to maintain the Gold Standard so long as they possibly could for they had no illusions about other standards.

Thus the Treasury officials outlined three objectives. Firstly, it was vital for Britain to avoid, and to be seen to be avoiding inflation. Secondly, it was undesirable and indeed impossible at that moment to formulate any judgement or policy on the question of 'pegging' the pound; but it was desirable to confer with the Bank upon some provisional policy (to be pursued, of course, in complete secrecy), for securing foreign currencies as opportunity offered for use in the event of some temporary collapse. Thirdly, settled and far-reaching international understandings both on gold policy and Reparations and debts were greatly needed, but they could not be secured just then and Britain had everything to lose by trying unnaturally to force the pace.<sup>20</sup>

In November 1931 Rowe-Dutton reported from Berlin on the financial outlook in Germany. He could see no prospect of Germany voluntarily abandoning the Gold Standard. This was confirmed at the end of the month when Layton entered into discussions with Brüning, Luther and other German officials concerning the Gold Standard and tariffs. Brüning could not contemplate going off Gold except to a definite figure (he did not say what figure), or to sterling if sterling were stabilised. Luther, however, was strongly against any departure from Gold.<sup>21</sup>

## ii) The Introduction of Import Duties.

Against a background of a large deficit in Britain's balance of payments the Abnormal Importations Bill was presented to Parliament on 16 November 1931. It gave the Board of Trade powers for six months to impose duties up to 100 per cent on a wide range of manufactured goods and similar powers were given to the Ministry of Agriculture.<sup>22</sup>

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19. According to the League of Nations publication by R. Nurske, International Currency Experience (Geneva, 1944), p. 131, the Tripartite Agreement came into being when the cycle of devaluations was complete. The immediate object was to prevent a reopening of the cycle and to regulate the dollar-sterling rate.

20. NC 8/12/2, 3 Oct. 1931.

21. T 188 23. For German reasons for not devaluing see H. Luther, Vor dem Abgrund 1930-1933 (Berlin, 1964), p. 154; Brüning, Memoiren, p. 395.

22. W. N. Medlicott, Contemporary England 1914-64 (1967), p. 269.

The Foreign Office realised that the conditions for British foreign policy were changing. Tariffs and sterling were Britain's "two trump cards in the game of foreign politics". The metaphor might have been taken further. As conditions were changing for economic rather than for diplomatic reasons, the Treasury and the Board of Trade might have been expected to have contributed more than ever before to decisions on how Britain should play its hand in foreign policy. The Foreign Office recognised the problem over tariffs. If these were not imposed wisely then they might serve as a battering ram and a form of economic warfare could result. With a sense of foreboding a question was posed: if Britain were not to advance on a broad basis - an 'all-in' solution to foreign policy problems - and no alternative policy were found, what was in store for Europe and what was in store for the world?<sup>23</sup> In other words, the Foreign Office believed that tariffs should not be considered separately from the problem of achieving a general settlement of political and economic issues such as armaments and Reparations. Rather, tariffs might be used as a bargaining tool.

The minutes of the Cabinet in early 1932 make plain that although there was considerable disagreement within the National Government over tariffs, there was a fear that as this issue had formed such an important part of the election platform, inaction might have brought the Government down.<sup>24</sup> On 4 February Chamberlain moved the financial resolution of the Import Duties Bill. He proposed a system of moderate protection. Among other things, Chamberlain claimed it was to be used for negotiations with foreign countries which had not paid very much attention to British suggestions. An effective instrument would also be acquired against those countries which discriminated against Britain. A general ad valorem duty of 10 per cent was announced along with the establishment of the Import Duties Advisory Committee.

Leo Amery, naturally, considered these moves to be in the right direction. He replied that, "It may be said that we forget that the 10 per cent is on top of exchange depreciation. But that depreciation has a protective value, so far as we are concerned, only as far as the Gold Standard countries, and then only so far as those Gold Standard countries have not taken special measures to counteract it." In the case of Germany, under the Emergency Decree of December 1931, all wages and salaries had been reduced by 10 to 15 per cent, prices and railway rates had been cut, and rents and mortgages had been reduced by 10 per cent. In Amery's opinion, these were all measures to neutralise any protective advantage which the fall in sterling had afforded.<sup>25</sup>

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23. CAB 24/255, CP 301, 26 Nov. 1931.

24. CAB 23/70, 5(32) & 6(32).

25. Parl. Deb. (H. of C.), Vol. 261, col. 287.

In April 1932 the IDAC made its first recommendation. In practice, a 20 per cent tariff was imposed on most manufactured imports. But the fall in the pound did help to ward off the additional shrinkage which would have accrued to British exports in 1932. Instead, exports to some countries began to revive in 1932 and Britain's share of world exports increased. By December 1931 sterling's rate had fallen from \$4.86 to \$3.25. This represented a 40 per cent appreciation in **those** currencies which had not immediately followed sterling.<sup>26</sup> Devaluation did not lead to a deterioration in the terms of trade. Rather, with the fall in prices of raw materials and foodstuffs, they actually improved. However, in competition with the sterling bloc, Germany rapidly lost her export capacity and her favourable balance dwindled in 1932 to a third of its 1931 magnitude.<sup>27</sup> German exports continued to fall until 1934 when they were only one half of their 1929 volume compared to the U.K. figure of 70 per cent.<sup>28</sup>

TABLE 8  
Index of British and German Prices during 1931 and 1932. 29  
(Third quarter of 1931 = 100)

	1 British Wholesale in Gold	2 German Wholesale Index	3 1 as % of 2	4 British Export Finished Goods in Gold	5 German Ex. Fin. Goods Index	6 4 as % of 5
1931 I	109.4	103.9	105.3	110.2	107.2	102.8
II	107.5	102.8	104.6	107.1	104.0	103.0
III	100.0	100.0	100.0	100.0	100.0	100.0
IV	78.5	98.2	79.9	75.4	96.3	78.3
1932 I	75.0	93.9	79.9	70.3	94.8	74.2
II	74.8	93.6	78.9	74.3	92.7	80.2
III	69.8	87.3	79.9	68.6	87.8	78.1
IV	66.0	82.6	79.9	65.1	90.6	71.9

26. Kindleberger, World in Depression, p.162

27. Ellis, Exchange Control, p.244.

28. Lewis, Economic Survey, p.92.

29. Ellis, Exchange Control, p.180.

### iii) The Policy on Reparations.

The full significance of the role of sterling for the course of economic developments in the rest of the world was to emerge only slowly in the course of 1932 and 1933. Perhaps policy-makers were prevented from gaining a clear picture of such developments by the tangled issue of war debts and Reparations which, with tariffs, tended to inhibit detailed consideration of all other matters of British external economic policy. Yet, the questions of the balance of payments and Reparations were closely linked.

The economist Henderson attempted to demonstrate, in an article published in February 1932, entitled 'German Reparations and British Industry', that the payment of Reparations by Germany was likely to be specially detrimental to the British economy. Both countries were largely specialised in similar activities and, as Germany could pay Reparations only by achieving an export surplus she would have to check imports and stimulate exports. For the twelve months before Britain left the Gold Standard, German exports, at 11.8 per cent of total world trade, exceeded British exports at 10.1 per cent, for the first time.<sup>30</sup>

The Treasury view of Reparations and war debts was that it had always been British policy that such inter-governmental payments should be cancelled or reduced to a minimum. The Treasury was aware that the question had become a vital one since all sections of British opinion agreed that the existence of such political debts had played a considerable part in aggravating the economic crisis and, in particular, had led to the heaping up of gold in France (together with the overvaluation of the franc), and the United States to the detriment of the whole world. The Treasury also agreed that Reparations had crippled British trade with Germany, a customer of particular importance. If cancellation were unobtainable it had to be realised that Germany's commercial creditors would not be in a position to accept any arrangement in regard to short-term credits until they had been assured that political obligations would not prevent Germany from honouring commercial debts. Reparations had to be suspended until commercial debts had been dealt with.<sup>31</sup>

Leith-Ross was unequivocal in expressing his opinion. It was useless, he wrote, to talk of a political truce with Germany (a Foreign Office idea), when eight million men were on the starvation line and, of course, absurd to talk of Reparations. The urgent need was to re-establish Germany's commercial credit and the natural way to do this was to cancel Reparations completely. Only such a definite clearance would reassure the markets and produce a natural inflow of foreign credits. If France would not cancel Reparations she had to be prepared to adopt artificial measures to "unfreeze" German

credits and so restore life to Germany's economic system.

Leith-Ross saw how the issue of Reparations was helping to determine the course of political events in Germany, but rather than perceiving any danger from the right he had in mind one of the results of the Russian Revolution. He wondered whether there was not a risk that the Allied Powers would be left with their war debts to pay America and a "Bolshevised" Germany which paid them nothing.<sup>32</sup>

Yet, although the Communists in Germany did gain seats in the two 1932 Reichstag elections, the most dramatic gains were made by the Nazis, even if they fell back slightly in the November elections. The British Chancellor, Neville Chamberlain, identified the Nazis as the real danger. But he considered that the means to avert the danger lay in the hands of France, a nation which Chamberlain clearly felt was unpredictable. He wrote, "With what seems to me an extraordinary failure of that logic which is supposed to be their special characteristic they insist on Reparations before commercial credits from Germany." This froze up British financial resources and threatened the stability of the pound which the French were so anxious to restore. Chamberlain thought that the most absurd part of French conduct was that while they kept the whole of Europe in a state of nervous anxiety and thereby precipitated the rise of Hitler to power, they made it impossible for Germany to pay any Reparations. She would only have a chance to do so if able to trade so as eventually to provide the surplus from which alone Reparations could come.<sup>33</sup> In these circumstances, therefore, commercial debt would have priority over sovereign debt. Keynes also thought that Germany's future capacity to pay anything to anyone was largely dependent on restoring her credit. In 'A Note on the German Riddle', which was circulated to the Prime Minister's Advisory Committee on Financial Questions, Keynes held France responsible for the way in which Germany's short-term creditors had fallen into a panic.<sup>34</sup>

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30. Henderson, Inter-War Years, p.92.

31. T 160 439 12704, 14 Nov. 1931.

32. T 188 21, 8 Oct. 1931.

33. NC 18/1/964, letter to Hilda, 6 Dec. 1931.

34. Brand papers, File 112, undated. Brand, Henderson, Layton and McKenna were also members of this committee.



In December 1931 a Special Advisory Committee of the Young Plan was called to meet under the auspices of the BIS at Basle. The Bank of England's records contain an anonymous aide-mémoire which constitutes, in rudimentary form, a minority report. The committee as a whole accepted the interpretation placed upon its terms of reference by certain of its members for the purpose of its official report. But some members conceived it to be their duty, in circumstances which they considered to be exceptional and far different from those contemplated in the Young Plan, to bring to the notice of the governments the steps necessary to restore Germany's credit and economic life, thereby enabling her to resume the obligations she had undertaken. Measures had to be taken promptly to avoid a German declaration of a moratorium. Apart from the restoration of confidence which would allow credit to be left in Germany, her balance of payments had to be freed from the transfer of all Reparations for several years.<sup>35</sup>

With the publication of the Basle report itself, Ramsay MacDonald called for a Reparations conference to meet on 9 January 1932. Draft proposals were prepared in Whitehall at the end of 1931. In the Government's view it was indispensable that there should be a complete suspension of all effective German payments, except the sums required for the service of the Dawes and Young Loans. Nothing short of this, it was held, would afford any possibility of restoring confidence in Germany. The Government did not therefore want to contemplate any continuation of German payments, but it was hoped that by aiming for a five year extension of the Hoover Moratorium, a three year extension might be secured.<sup>36</sup>

There was, however, a considerable difference of opinion on how long payments had to be suspended. With the formation of MacDonald's second National Government Snowden, who had been Chancellor of the Exchequer, entered the Cabinet as Lord Privy Seal. He was disturbed at the position in which short-term credit had been left. It was certain that some arrangement would have to be made to continue the moratorium in whole or in part after February 1932 when the Standstill came to an end. The British creditors had insisted, however, on a pari-passu settlement of the Reparations question (the Standstill was agreed to pending some permanent settlement by governments). Thus Snowden felt under a moral obligation to the bankers who had been given this tacit assurance. He felt that they would not be content with a mere extension while governments were "shilly-shallying" about Reparations.<sup>37</sup>

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35. BE OV34/148.

36. T 160 450 13050; T 188 32.

37. T 160 450 13050, letter to FLR, 29 Dec. 1931.

The Governor of the Bank of England told Leith-Ross and Sir Warren Fisher that he also wanted a settlement which would restore confidence in Germany's credit and result in German bills being freely accepted. But he could see no hope of this from the proposals which were under consideration. A two year postponement, even with some arrangement about revision at the end of that period would be interpreted as a signal to the market to withdraw money from Germany in the meanwhile. The Governor could not afford to oppose such a policy as he could not afford to be caught again with a volume of credit such as then existed. Leith-Ross noted that the Governor spoke with much feeling and was evidently gravely disturbed at the possible effects on the London market of the Government's proposals.<sup>38</sup>

Sir Ernest Harvey joined in a further conversation on New Year's Eve. The two Governors declared that nothing less than a complete suspension of Reparation payments for five years would be any good for the purpose of getting credits to revolve. In their opinion, a two or three year suspension, in order to bury the Young Plan decently and to appease the French, would have led to a complete jam over the Standstill bills.<sup>39</sup> The Treasury officials, however, considered the Governors' ideas to be politically disastrous and financially suicidal. Leith-Ross informed Chamberlain that the Governor probably reflected the view of the market, but that the market was mistaken as to the wisdom of pressing for a five year moratorium in view of the French attitude.<sup>40</sup>

The Chief Economic Adviser developed this argument for the benefit of the Foreign Secretary. The main question was whether the Government was going to try to force its desire for a permanent settlement on the Reparations conference, or was prepared to arrive at a compromise acceptable to the French. Insisting on cancellation or a five year moratorium would produce a "row" which would make conditions in Europe worse, and harm British interests. Leith-Ross thought that there would be something to be said for such action if the French were to be absolutely intransigent and insisted on collecting the full Young annuities from 1 July 1932. But, in fact, he believed that the French were prepared to give Britain what it wanted in substance provided concessions were made to them on questions of form, namely a two or three year moratorium as a first step towards general cancellation.<sup>41</sup>

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38. *ibid.* note of conversation, 28 Dec. 1931.

39. T 188 32.

40. T 160 450 13050, notes by FLR, 31 Dec. 1931 and 1 Jan. 1932.

41. FO 800 286, 1 Jan. 1932.

At this moment the tactics of the German Government added to the complications of resolving the Reparations issue speedily. The Foreign Office had already received a note from the German Government pointing out the impossibility of paying debts on the expiry of the Standstill.<sup>42</sup> But, at the beginning of 1932, Brüning issued a startling public statement to the effect that Germany would be obliged to declare at the Reparations conference that it would be impossible to pay Reparations either in the present or in the future. Furthermore, Brüning told the British Ambassador that a moratorium, even for five years, would be useless. For no one would lend Germany any money, nor would confidence be revived.<sup>43</sup>

The Foreign Office did not know whether Brüning was bluffing or not. But Sargent hoped that it might frighten the French into accepting the British idea of an 'automatic pressure gauge'. Germany might then be convinced that a moratorium would mean the end of Reparations, assuming a formula was found to placate the French. Sargent also thought that a German repudiation of Reparations could actually improve German credit in purely commercial quarters.<sup>44</sup>

The Foreign Secretary, Sir John Simon, laid before a meeting of the Cabinet on 11 January 1932 a memorandum on debts and Reparations. It pointed out that the Young Plan envisaged a rising volume and value of world trade. But if Germany failed to make payments under the Plan and if France then resumed full liberty of action, then, it was submitted, Britain would be bound to aid Germany if satisfied that she had suffered an unprovoked act of aggression. Simon accepted the unanimous view of the Basle committee of experts (which included four neutrals), that Germany had to be given time to recover before payments were resumed.<sup>45</sup> The Cabinet noted that if Germany deliberately threw over the Young Plan then, under the 1930 Hague Agreement, the creditor nations had the right to seek powers from the Permanent Court of International Justice to resume their full liberty of action.<sup>46</sup>

Snowden felt strongly that the Reparations conference would be regarded as a tragic failure if it broke up with a mere temporary patch-up like the London Conference of the preceeding July. In that event, he supposed, confidence would be destroyed instead of being strengthened, and governments would stand before the world as incapable of dealing with the pressing world economic tragedy.<sup>47</sup>

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42. T 160 436 12630/02.

43. T 160 437 12630/02/2, Telegram to FO, 8 Jan. 1932.

44. FO 15904 C220, 8 Jan. 1932.

45. CAB 24/227.

46. CAB 23/70.

Academic opinion was also in favour of the abolition of Reparations, and in the case of an article by Keynes in the New Statesman this was put forward passionately. The Treasury noted that Keynes had seen the Prime Minister and that the article came down in favour of the Government's policy. That policy, it was claimed, had not been inspired by Keynes as the French, who "hated" him, might have thought.<sup>48</sup>

There was thus widespread support for the idea of a long suspension or abolition of Reparations. The British Government also desired such action but feared that the French authorities would block any approaches to a practical solution. Yet the French represented only part of the problem. Leith-Ross declared that it was impossible to work with the United States. Congress had set its face against debt revision however sympathetic the Administration was. In order to prevent Germany being driven to financial and political catastrophe, war debts owed to Britain would have to be used as a lever to secure outright cancellation. Fisher added that Britain would have every justification for the suspension of payment of tribute to the United States. Accordingly the Treasury's policy was formulated: if America pressed Britain for payment then Britain would pass on the demand to Germany. But if Germany refused to pay, Britain would not pay America. In the future, therefore, Britain would only pay to America what was recovered from Germany and Allied debtors but no more.<sup>49</sup>

At the Reparations conference to be held at Lausanne the Government's objectives were to achieve a moratorium for as long as possible and a mechanism to prevent payments for as long as Germany was unfit. Whereas under the Young Plan the onus was on Germany to prove she could not pay, under the system proposed the onus would be on the creditor powers to prove she could pay. If the receipts from Germany were technically only postponed, the Government would not consider the moment auspicious to ask the U.S. Government to cancel or reduce the British war debt to America, but would ask for a temporary suspension.<sup>50</sup>

At this juncture Leith-Ross seems to have advocated that the conference should be postponed. France was undergoing a domestic political crisis and elections were looming in that country and in Germany. The Foreign Office felt that it was important for German and for world opinion that

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47. T 160 13050, letter to FLR, 2 Jan. 1932.

48. New Statesman, 16 Jan. 1932; T 160 436 12630/1.

49. T 160 450 13050; Memo. 28 Dec. 1931.

50. FO 15904 C258, 11 Jan. 1932.

the conference should be held without delay; the immediate British objective was to prevent a German collapse and an election could result in the partial or complete accession to power of the National Socialists.

Brüning had expressed the hope to Rumbold that a further six months of economic depression would bring home to France and the United States the necessity of changing their standpoint. It was believed in the Foreign Office that this view was curiously similar to that held by Montagu Norman and certain City circles: that "The European pot is to be kept boiling in the hope that it will thus surely boil over in the next few months". A compromise which would allow governments to evade or avoid the ultimate issue of cancellation would thereby be prevented. But the risk was not thought to be worth taking: opinion was likely to be further depressed if governments did not deal with the one cause of the economic blizzard which would be affected by government action.<sup>51</sup>

Nevertheless, the British Government won around the different parties to the idea of postponing the conference until June 1932. This, Chamberlain hoped, would mean that the Government would only have to ratify an agreement worked out by experts beforehand.<sup>52</sup> But officials in the Berlin Embassy were also far from happy with this development. Rowe-Dutton pointed out that the conference could only be postponed on a deliberate basis of uncertainty as to what was to happen in June. By then, he postulated, Brüning would either be in a stronger position vis-à-vis Hitler, or the Chancellor would resign and force Hitler to go to the conference. In either event, Germany's hand would be strengthened. If a default was the only way to cancellation of Reparations, the Germans would be in a better position to do this later in the year. And with the postponement of confidence inside Germany, Rowe-Dutton did not feel at all secure against a general foreign moratorium.<sup>53</sup>

It was also reported that the Nationalist press regarded the continuance of the Hoover mechanism as a French scheme to keep the Young Plan in existence. Rowe-Dutton considered that Brüning's best defence was to hold up the Basle report and to refuse to step outside it. He believed that Brüning was too great a statesman to be inflexible but that he had to carry other frightened ministers with him who refused to budge.<sup>54</sup> Rumbold judged that Germany's financial, economic and political situation fully justified Brüning's apprehension concerning postponement of the conference. The

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51. *ibid.* and C293.

52. NC 18/1/767.

53. T 160 440 12800/2, letter to FLR, 13 Jan. 1932.

internal and external financial strain on the Reichsbank remained very severe and the losses of gold and foreign exchange continued. Estimates of revenue had grown progressively worse since the Basle report and the economic facts appeared to point towards a growing atrophy of all activity.

The Ambassador emphasized external factors as an important cause of the depression. Germany's trade figures showed the declining purchasing power of the world and the progressive restrictive effect of protective measures in other countries; many branches of the textile industry had been nearly paralysed by import restrictions. Observers were therefore of the opinion that Brüning's estimate of being able to hold the country together till June was too optimistic. The conclusion drawn in the Berlin Embassy was that if matters were allowed to drift there was a real risk that the Brüning Government would be swept away long before October and replaced by a National Socialist combination which would flatly reject emergency plans and refuse all further Reparations payments.<sup>55</sup>

In London it appeared that there was no hope of the French accepting the proposal for a long-term moratorium, and that they would only agree to a two years' moratorium subject to the delivery of Railway Bonds. But neither Britain nor Germany would accept this. Thus officials were forced to accept an adjournment. Leith-Ross noted that the London market was very emphatic in its view that a permanent settlement was the only thing which would do any good. As this could not be attained, the market was in favour of adjournment in the hope that conditions would be more favourable later. There was much to be said for such sentiments as the question was largely one of maintaining confidence in a crumbling situation. Leith-Ross wrote to Rowe-Dutton, "You will realize that the attitude of ministers here is necessarily to a large extent influenced by the opinion of the Bank of England as to what the market wants." With all the dangers of a further period of uncertainty Leith-Ross hoped that the City would not be shown to be unduly optimistic in thinking that the dangers could be survived and that a permanent settlement would be possible the following year.<sup>56</sup>

The Cabinet considered the problems which resulted from the postponement of the conference. France, while not refusing the possibility of a short moratorium, insisted on the Hoover mechanism, which included the payment by the Reichsbahn of marks to the BIS which relented them to the Reichsbahn. After the German Government had refused the first proposal for a moratorium on Hoover conditions, strong pressure had been put on Germany by the British Government to accept. The Foreign Secretary told the Cabinet that it seemed possible that Brüning, under this pressure, would agree to continue the moratorium on the existing conditions, with the additional stipulation that



the Lausanne conference should meet within six months and that the issue would be properly defined. It was thought that Britain would then be in a strong tactical position vis-à-vis the French. The Cabinet also considered what the effect would be on Britain's banking position if nothing were done. The Chancellor thought that the situation was slightly better in regard to the Standstill Agreement owing to the widespread belief that whatever governments might say, the payments of Reparations had come to an end.<sup>57</sup>

It appeared that there was general agreement that an adjournment of the conference was advisable in order that discussion could take place in the most favourable conditions. Yet Leith-Ross thought that it followed that some further temporary moratorium had to be arranged to give a necessary margin of time for the conference. For it was impossible to be sure that a conference convened after the French elections could come to any conclusion before the Hoover Year expired on 30 June 1932. Leith-Ross also imagined that bankers would consider a further postponement of Reparations an essential pre-condition to a prolongation of the Standstill Agreement. Thus he wanted to obtain the agreement of the French to a year's extension of the moratorium as a corollary to adjournment of the conference. Germany would thereby be liberated from the legal obligation to make any effective payments.

The Treasury official Waley saw immediately that such ideas were unworkable. An offer made to Germany with no corresponding promise from the U.S.A. would have been very objectionable to the French. It would also have been objectionable to the Germans as exposing them to the risk of having to swallow the Hoover "hocus-pocus". Such an elaborate ritual, Waley opined, would give the impression that the Hoover mechanism had some relation to realities and was not all make believe.<sup>58</sup>

At the beginning of 1932, therefore, British policy towards Germany was somewhat directionless. Although towards the end of January it became apparent that the Standstill Agreement would be renewed even though a Reparations settlement remained evasive, the Lausanne conference had been postponed until the very end of the Hoover Year. More than this, Chamberlain admitted that it was proving impossible to agree to a formula (for settlement) before the elections in France, Germany and U.S.A.<sup>59</sup>

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54. FO 15905 C765, letter to FLR, 22 Jan.1932.

55. T160 437 12630/02/2, Rumbold to FO, 20 Jan.1932.

56. FO 15901 C691, 13 Jan.1932.

57. CAB 23/70, 4(32).

58. T160 437 12630/02/2, mins. 20 Jan.1932.

59. NC 18/1/770, letter to Hilda, 13 Feb.1932.



But the Foreign Office did not want efforts to slacken in bringing about complete cancellation, even at the temporary risk of having to continue to make payments to the U.S. until the new Congress was prepared to revise Britain's war debt settlement. Sargent was afraid that even by June the position would not have changed: America would refuse to discuss war debts, France would refuse to discuss cancellation unless war debts were discussed, and Germany would refuse to discuss anything other than cancellation. British policy was opposite to French policy; there was no wish to make a decision dependent on American action. Yet, there was great danger if Britain acted unilaterally.<sup>60</sup>

Vansittart was also emphatic that things could not be allowed to drift. But, always suspicious of German motives, he thought that as so much British capital was tied up in Germany, Britain had an unanswerable claim on Germany to shoulder a share of provision which might not entirely suit her. Leith-Ross had the support of the Governor of the Bank of England in disagreeing with Vansittart. Bullying would not produce the desired results but could push Brüning into declaring a general moratorium.<sup>61</sup>

Cabinet discussions towards the end of January 1932 reveal that the issue of war debt to America prevented the formulation of a positive policy towards Germany. Simon thought that even if no conference took place Germany, from her own point of view, would not be in a bad position. If she had to default on her payments she could always point to the Basle report as a reason for not paying. From the French point of view there also appeared to be something to be said in favour of technical default by Germany: it would strengthen the French case for avoiding her war debts to Britain and U.S.A. Consequently, Europe appeared to be heading for a situation where there was no agreed suspension. As for Britain, Simon considered that the main object in an agreement was to improve the economic position of Europe and to reassure the City of London. But it was possible that these objectives would be achieved anyway by the new Standstill Agreement.<sup>62</sup> In these circumstances, the only instruction which Vansittart was able to issue to the British Ambassador in Berlin was that it was most important that everything should be done, both in the political and financial spheres, to keep the international atmosphere as tranquil as possible until the conference eventually met.<sup>63</sup>

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60. FO 15905 C638,min. 20 Jan.1932.

61. *ibid.* C640, 20 Jan. 1932.

62. CAB 23/70,8(32), 26 Jan. 1932.

63. T 160 437 12630/02/3, 5 Feb. 1932.

The continuing debate over the economic effects of Reparations showed that not all those responsible for policy in London were content to allow matters to drift. The Director of the Federation of British Industries, Sir Roland Nugent, informed Walter Elliot, the Financial Secretary to the Treasury, that his organisation felt from a purely industrial point of view that there were very grave objections to a complete cancellation of Reparations. Hopkins firmly rejected such a notion. It was useless to suppose, he wrote, that a great nation like Germany could be held down permanently by the imposition of a foreign tribute; the future would really be determined by quite different considerations. British policy towards Reparations had, for the previous ten years, consistently been a policy of cancellation. For three reasons Hopkins thought that the FBI could not be serious. Firstly, Reparations were "dead", which even the French recognised but did not dare say so. Secondly, the necessary dependence of Germany upon foreign capital and the development of its internal economic organisation would probably be adequate safeguards against industrial supremacy. And thirdly, Britain, at the moment it was abandoning Free Trade, could afford to look with more complacency upon the dangers of foreign competition.<sup>64</sup>

Leith-Ross, too, developed his earlier analysis of the relationship between politics and economics in late Weimar Germany. He thought that the need for a solution was vital but he did not agree that there was a danger to Europe from German industrial competition - one of the arguments also advanced by France for not ending Reparations. The danger to Europe lay rather in a Nationalist government winning power in Germany with the policy of repudiation of the Versailles Treaty. In the opinion of Leith-Ross, the Nationalist movement in Germany was predominately the result of continuing economic distress; six million unemployed provided a fertile ground for Hitler and the "Soviets". The immediate objective had to be to set Germany on her legs again.

Leith-Ross also took up the Henderson thesis that Reparations had forced Germany to dump and that such forced selling was the real danger to the British economy. The crisis had also forced Germany to reduce her imports. To substantiate this, Leith-Ross reproduced figures for British exports to Germany.

1927	1928	1929	1930	Jan.to Sept.1931
£42 million	£41 million	£37 million	£27 million	£13.5 million

An expanding Germany would therefore benefit British industry more than threaten it. The conclusion was that both from the wider political and financial and economic viewpoint it seemed better to run the risk of Germany being too strong rather than the risk of her being too weak.<sup>65</sup>

In the following years Britain did indeed run the risk of Germany being too strong. Yet by then, of course, the very danger from political extremism which such a policy was designed to avert had already taken hold of Germany. In reply to Leith-Ross, the Bank of England official Rodd thought that the important question was whether the Nationalists would be as vigorous in their demands for treaty revision if the Reparations burden were entirely removed. It appeared to him to be a very dangerous assumption that Reparations and Hitler cancelled each other out. Nor did Rodd think that Reparation payments had stimulated German exports as much as Henderson maintained. And, as prices had been falling steadily, the volume of imports had not declined to the extent that their value had diminished. The high standard of life in Germany pointed to the fact that in time Germany would be able to pay some Reparations. To Rodd, therefore, there was something to be said for the thesis that Germany, relieved of Reparations, with her highly rationalised plant and her unrivalled productive and marketing organisations, would be in a position to capture the world's markets. From other points of view, the case for cancellation was strong, but Germany's potential power to compete successfully was such that it certainly could not be maintained on purely economic grounds that she would never be able to pay anything.<sup>66</sup>

However, Leith-Ross was not to be diverted from consideration of the immediate political ramifications of Reparations. He was convinced that the right policy for Britain, in the interest of Europe as a whole, was to give as much support as possible to the moderate element in Germany by adopting a reasonable policy. In that event, if Hitler after all won the day, France would have the support of the rest of the world; but if France refused to accommodate a moderate policy she would have to face Hitler without any support abroad.<sup>67</sup>

The Berlin Embassy thought that there could be little hope of improvement for Germany without modification of the policy of sacrificing everything in order to keep to the Gold Standard. It was impossible to guess at when the strain would manifest itself. Nor could there be any doubt that the German people saw every justification for proclaiming their inability to set a date for the resumption of Reparations. The Foreign Office believed that rather than making much financial or material difference to the state of Germany, the effect of the cancellation of Reparations would be mostly psychological.<sup>68</sup>

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64. T 160 729 12829/1.

65. T 160 729 12829/1; BE OV34/3; Memo. by FLR, 'Germany's Competitive Power', 12 Jan. 1932.

66. BE OV34/3, note, 22 Jan. 1932.

67. *ibid.* FLR to Rodd, 29 Jan. 1932.

Indeed, Sargent noted that the French minister Berthelot had accused Britain of adopting the German thesis that Germany was not in a position to pay Reparations. Sargent protested that the thesis Britain had adopted was that of her bankers: in all probability Germany would be able to pay Reparations at some future date, but the restoration of international confidence was the over-riding necessity and this would be restored only by the creditor governments renouncing forthwith and entirely any such hypothetical claim on the future. Sargent admitted that there might have been divided opinion as to the correctness of the bankers' diagnosis, "for after all they are neither politicians nor psychologists". Indeed, a good case could even be made out for maintaining alive claims on Germany on the assumption that they would be realisable once more when prosperity had returned.

Thus the bankers' thesis was accepted because it was realised that the Germans had decided to defy creditor governments over Reparations, and in the face of such a "will to default", Britain was no longer strong enough to make good its claims. As for the technical statements prepared by the Treasury to show that there was no danger of Germany becoming once again a dangerous economic rival, the arguments sounded convincing to Sargent but he did not think that prophecies based on economic arguments were particularly trustworthy. Rather, the real argument on which to rely was that the crisis was so dangerous that Britain was bound to take big risks in order to save itself from being involved in universal collapse. One of those risks was the possibility of having once more to resume the struggle with Germany for the economic markets of the world.<sup>69</sup>

Leith-Ross added to the case for cancellation by pointing out how the absorption of gold by the U.S. and France had been an important element in producing the world economic crisis; there was no reason, therefore, why Britain should go out of its way to impoverish Germany in order to increase the creditor balances of France and the U.S. The U.K. was, of course, very much interested in the recovery of Germany's commercial credit; she needed to develop and maintain a very large export surplus in the future to meet her commercial obligations. Leith-Ross did not think that this would be an easy task with the development of tariffs. In his opinion, German exports had already been stimulated, by price cutting, because of the exaction of Reparations.<sup>70</sup>

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68.FO 15936 C1110, Memo. 'Financial Position of Germany', 27 Jan. 1932.

69. FO 15907 C1262, 12 Feb. 1932.

70. T 160 436 12630/2, 30 March 1932.

Towards the end of April 1932 a British delegation to the League of Nations in Geneva comprising, among others, MacDonald, Simon and Leith-Ross met Tardieu and Brüning. British officials believed that Brüning was trying to play upon fears of German industrial revival in claiming that Britain would experience later the evil consequences of French investments in German industry. Vansittart remarked that the Germans were always at such a game and often succeeded with Montagu Norman. It was also thought that German industry could not be started again without fresh capital and that this capital could only then be supplied by France. The French were expected, after their experiences of government securities, to prefer giving their money direct to industry rather than to the German Government to pass on to industry.<sup>71</sup>

iv) The Lausanne Conference.

In the months leading up to the Lausanne Conference the situation in Germany was monitored by British policy-makers with great concern. The reports from the Berlin Embassy issued by Thelwall (Commercial Counsellor) and Rowe-Dutton (Financial Adviser), were circulated as usual to Government Departments and the Bank of England. Thelwall warned the Board of Trade in February that as German exports fell it seemed inevitable that a moratorium would be placed on foreign commercial debt. Rowe-Dutton revealed that, "Both Thelwall and I are very anxious indeed.....the thing may go hopelessly wrong. I do not see any step which can be taken inside Germany which can remedy the situation". Cancelling Reparations was not enough. The Bank of England did not know quite how to interpret such opinions. Rowe-Dutton was thought to be excessively gloomy and alarmingly pessimistic; yet this was also thought to be natural and well-founded.<sup>72</sup>

But Vansittart agreed that Reparations and debts were only a fraction of the problem: Germany had made the discovery which the French and everyone in England (with the exception of Lloyd George and a few friends), had made long ago, that mere cancellation was not enough to set the German economic machine going again. Thelwall warned that those who expressed doubts as to Germany's ability to continue unimpaired the service of her long-term debt should not be ignored. The Standstill Agreement had provided a certain alleviation in interest rates but it would only postpone the day when Germany would find it impossible to transfer the sinking fund payments. And from the City Nigel Law reported that people were beginning to ask themselves how much longer Germany could continue to pay even the interest on her foreign debt, especially as the new British tariff would accelerate the decline in her export surplus.<sup>73</sup>

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71. FO 15908 C3431, 6 June 1932.

Thelwall indicated how the economic machine might be restarted. Germany did not possess the means to help herself. Other countries had to allow Germany to trade and to finance her imports and initial production. This could only be effected through commercial bills in the ordinary way and partly by conversion and consolidation of a portion of the foreign loans which were frozen. Fresh borrowing would be unnecessary and harmful. Thelwall emphasised that when the existing foreign loans in Germany had been reorganised for the purpose of again being employed in the financing of trade, it was of vital importance that the question of future loans was dealt with so as to avoid the wild and indiscriminate lending of the 1924-9 period.<sup>74</sup>

In March 1932 Leith-Ross visited Berlin to observe for himself the continuing economic and political crisis. He found the atmosphere to be one of gloom and nervousness. There was a widespread belief among bankers that the German Government might be compelled to declare a moratorium in the following weeks. Luther was emphatic about the difficulties of securing the necessary foreign exchange to fulfil obligations under the Standstill Agreement. There were constant complaints against the restrictions on German exports. Feeling against France was particularly bitter; British tariffs appeared to arouse considerable apprehension but less complaint. Leith-Ross gained a general impression that Germany could hang on for a few more months if there were no further shocks.<sup>75</sup> When this report reached Vansittart he commented, "We have had this few months more tale fairly often now".<sup>76</sup>

Indeed, the Under-Secretary clearly displayed ambivalence in his attitude to Germany. He considered that if she was to be discharged at Lausanne in a creditable manner and not by unilateral action (on that point Britain agreed with the French), then "We are on very strong ground for insisting on our old and great foiled friend, the political truce." Vansittart thought that that was a reasonable and constructive quid pro quo but was doubtful whether the Brüning Government could be forced into granting it without falling.<sup>77</sup>

In the last despatch before the Lausanne Conference convened, Rowe-Dutton surveyed financial developments in Germany since the Young Plan. In explaining how the whole position was growing increasingly artificial, he gave a good indication of how Brüning's policies foreshadowed those that were to be employed, albeit more systematically, by the National Socialists. While autarky

72. BE 0V34/3, letter to SDW, 9 March 1932, note by Bank, 18 March 1932.

73. FO 15903 C2030, letter to FO, 10 March 1932.

74. FO 15936 C354, Report, 25 April 1932.

75. BE 0V34/3, Memo. 14 March 1932.

76. FO 15936 C2234, 21 March 1932.

77. FO 15908 C2084, 17 March 1932.



was not accepted, many individual measures were taken under Brüning which were scarcely reconcilable with any other idea. The intention was to prevent withdrawal of further foreign capital, to remain on Gold and to pay debt interest. Thus an attempt was made to reduce payments abroad by cutting down imports. Yet, if that proved to be insufficient, Rowe-Dutton had no doubt that whether by agreement or not, the service of the foreign debt would be curtailed, first by suspending sinking funds and then by reducing interest rates. The Financial Adviser could not see what could prevent such a default. In that case Germany would have cut another and very important thread connecting her with the outside world. It was likely that reprisals against German exports would follow, with repercussions for German imports. It was a short step to government regulation of trade leading to a degree of state control incompatible with the continuance of the country in the system of private capitalism.<sup>78</sup>

Towards the end of May Chamberlain thought that the outlook for Lausanne was improving. He realised that the chances of reaching an agreement would be improved if political questions could be discussed simultaneously. But he did not see a way to bring Germany to agree to a continuance of the status quo in Europe.

Responding to Chamberlain's request for advice Leith-Ross declared that he believed that it should be possible to reach an agreement for the cancellation of Reparations signed, though not ratified, on the basis of an understanding that debts due to Britain would be cancelled, and that Europe would act in concert in dealing with the American debts. Such an agreement would not be formally ratified till a settlement had been reached with America; but it could be put provisionally into effect at once. Leith-Ross felt that some further suspension was probably inevitable, but he did not think that it would be advisable because of the general uncertainty involved. On the other hand he also recognised the seriousness of a crisis with America which, while it might be inevitable, should be deferred for as long as possible.<sup>79</sup>

On 30 May 1932 Brüning was forced from office. Ramsay MacDonald found the news very disquieting. Britain, he told Simon, had to lead in Europe and had to start at Lausanne. There was a need to deal with all economic questions: simply to allow the Ottawa pledge in the House of Commons to let the world wait upon Britain's Empire arrangements would be ridiculous and futile.

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78. FO 15937 C4550, 12 May 1932.

79. T 172 1788, notes, 25 & 27 May 1932.



MacDonald concluded, "We really must retain our big mind - God knows we shall need it before things settle down."<sup>80</sup> The day after Brüning's resignation, the British Foreign Secretary confirmed that the policy in regard of Lausanne was that there should be no further payments by Germany, so long as the new Government did not "blurt out" its demands. When the American presidential election was over on 5 November, Britain could put forward the proposition that payments to the U.S. should cease.<sup>81</sup>

After talking with Neurath (German Foreign Minister) a week later, Simon appeared to be convinced that there was a real danger that Germany would default on debt repayments and that the international capitalistic structure would be severely shaken as a result. Thus for this reason, and to prevent the U.S. insisting upon receiving payment, Lausanne had to reach complete agreement about cancellation.<sup>82</sup> Indeed, in May the British Government omitted from its budget for the fiscal year 1932-3 all provision for both payments to the U.S. and receipts of Reparations from Germany. The Chancellor explained that these two items were self-balancing and that their amounts were uncertain in the light of future events.<sup>83</sup>

The chief fear felt by the Treasury in regard to the new government in Germany and Reparations was that Dr. Luther would be dismissed from the Reichsbank and replaced by Dr. Schacht, and that the latter might lead the German delegation at Lausanne. But British officials were reassured when Luther received the confidence of von Papen and it appeared that Schacht would not go to Lausanne.<sup>84</sup> It is ironical that the Treasury were relieved when Schacht did eventually replace Luther when the Nazis came to power a few months later.

The Lausanne Conference convened on 16 June 1932. In spite of his avowed policy, Sir John Simon evidently felt constrained at the negotiating table. There was, he reported to Vansittart in London, very great difficulty in reaching clear cut decisions without bringing down upon their heads denunciation from across the Atlantic which might have made the debts to America a presidential election issue. Simon felt that the transfer of great blocks of payment across frontiers without any corresponding return in the form of commercial trade had ruined both the circulation of commerce and the credit and confidence of people. But he was not able to say this at the conference.<sup>85</sup>

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80. FO 800 286, letter, 31 May 1932.

81. CAB 24/230 (191).

82. CAB 24/23a (193).

83. H. Feis, 1933: Characters in Crisis (Boston, 1966), p. 17.

84. FO 15944 C4454, note by Sargent, 3 June 1932.

85. CAB 23/71, 37(32), letter, 20 June 1932.

At this point, Montagu Norman privately considered the possibility of assistance to Germany, either in the event of Lausanne imposing a burden or in order to allow time for a settlement to take effect. The Governor thought that expectations of a short-term credit ought not to be encouraged: there was too much clearing up of the short-term position to be done first. If credit were to be given it had to be large and on a relatively long-term. But what Britain did depended upon the actions of other countries; in particular exchange controls needed to be removed so that international payments could be resumed. The Governor's embryonic scheme was for a minimum of £75 million to be made available for a term of four or five years. An essential condition would be that the Standstill creditors should not ask for more than perhaps 20 per cent per annum.<sup>86</sup>

Nigel Law described the effect of the conference on the City. For the first time, in an international conference, he thought that the City was expectant and hopeful, even if it was a hope bred of despair. Business was at a standstill waiting on events. Law claimed that if the conference were to fail there would be as near a panic as was ever seen in Britain, and that a fresh crop of delibertate and unconcealed defaults would be psychologically far more dangerous than the Standstill Agreements and transfer postponements which served to hide future losses.<sup>87</sup>

Reparations were effectively annulled at Lausanne with the pretence of a final payment by Germany. In spite of some difficult moments the British delegation was able to bring about a compromise between the French and Germans. Under the Final Act of 9 July, Germany was to transfer Rm3 milliard in bonds to the BIS. Yet the accompanying 'Gentleman's Agreement' made clear that payment would only take place if the Agreement was ratified, and ratification itself was made dependent upon a general settlement of debts. This solution conformed to the plan which Leith-Ross had put forward in May.<sup>88</sup>

While the City was very pleased with the settlement, the failure to cancel Reparations outright did nothing to reduce resentment in Germany.

As the Lausanne Conference came to a conclusion the Ottawa Conference, which was to be held in August 1932, became the major preoccupation in terms of policy-making. Indeed, Lausanne gave the President of the Board of Trade an opportunity to speak to Neurath about coal restrictions. The latter hoped that as soon as the Ottawa Conference was over it would be possible for Britain and Germany to enter into commercial negotiations. The state of Britian's coal exports to Germany had become a matter of great concern to the Board of Trade when the British export quota had declined from 420,000 tons per month in October 1931 to 125,000 tons in April. Such a reduction was taken as evidence that Germany had discriminated against British trade.

This would have been a contravention not only of the 1924 Commercial Treaty but also of a secret formal declaration, made at the same time as the Treaty, to the effect that the German Government would not modify to the detriment of the British trade the state of affairs then obtaining in U.K. coal exports. At the insistence of the Board of Trade the Foreign Office instructed Ambassador Rumbold in March 1932 to make repeated complaints to Brüning. The German response was that British emergency duties and the Import Duties Act had in some cases fallen with special severity on German trade.<sup>89</sup>

In June 1932 the Board of Trade appeared to recognise the political implications of tariffs in a memorandum entitled 'Economic Questions at Lausanne'. According to this document, the British Government proposed to endeavour, after Ottawa, to secure reductions of duties by means of bilateral negotiations with particular countries. It was also hoped that the effects would be generalised by the operation of the Most Favoured Nation clause.<sup>90</sup>

Indeed, the British Government aimed to lower, rather than raise, tariffs at Ottawa.<sup>91</sup> Yet, according to Drummond, there is no evidence that consideration was given in the Ottawa preparatory discussions to the possible interactions between Ottawa, Lausanne, and the prospective World Economic Conference.<sup>92</sup> Finally, the British Government only had the most remote responsibility for the outcome of the somewhat chaotic Ottawa Conference at which Imperial Preference was established, not just by the reduction of tariff barriers between Empire countries but also by the erection of further tariff barriers against foreign goods.

By the end of 1932 Britain and Germany had opened commercial negotiations. It was reported from Berlin that the Germans were very anxious to reach an agreement. But they were also very concerned at the effect of sterling's devaluation and its newly-acquired unpredictability. The German authorities

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86. T 160 442, 12800/017, note, 30 June 1932.

87. FO 15903 C5806, 24 June 1932.

88. T 172 1787.

89. BT 11 138 C.R.T. 7082.

90. T 160 440 12800/01.

91. CAB 23/72, 46(32)1.

92. I.M. Drummond, Imperial Economic Policy, 1917-1939 (1974), p.218.

feared that any concessions which they obtained might be destroyed by a drop in sterling. At the same time it was still felt that a large proportion of British duties were "specially injurious" to Germany and had, therefore, to be reduced without corresponding German concessions. It was also made plain that Germany no longer felt bound by the secret note in regard to coal, as conditions had changed so much since 1924. Indeed, Britain was able to conclude a trade agreement with Germany, but not until 1933, by which time the National Socialists had taken power.<sup>93</sup>

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93. BT 11 138 C.R.T. 7082, Memo. by Thelwall, Berlin, 28 Dec.1932.

## CHAPTER IV

### The British Response to a National Socialist Germany in 1933.

Hitler's accession to the German chancellorship on 30 January 1933 was not generally viewed as a political development of overwhelming importance for international relations. In the succeeding months, Germany was rarely the focus of attention for the British public. It was recognised in British political circles, however, that the election of the National Socialists would create fresh difficulties for the policy-makers, even though the 'problem of Germany' had already been acute for some time. If no way was to be found out of the impasse it was difficult to see how German claims for equality of status, and hence rearmament, were to be denied.

With the collapse of the Weimar Republic some in Britain saw that opportunities had been lost. It has been suggested that there was a sense of frustration within the Foreign Office at the failure to co-ordinate policy effectively with the Treasury and the Bank of England. The somewhat novel notion of viewing economic concessions as a potential political weapon had not made much of an impression.<sup>1</sup>

While prevailing opinion in Britain might have been that Hitler had to be given a chance to settle down, speculation being futile until he had proved himself in office, the Foreign Office certainly did not conform to this pattern.<sup>2</sup> To these officials the reports received from the Berlin Embassy were of vital importance in helping to form conceptions of National Socialist Germany. The opinions of the Ambassador, Rumbold, and those of Thelwall (Commercial Counsellor), and Pinsent (Financial Adviser), were held in high esteem. Recognising the parlous state of the German economy, the diplomats were filled with a sense of foreboding and anticipated international repercussions in the near future. Some foresaw that National Socialism pressaged a future fraught with danger.

In January 1933 Germany was still in the trough of depression. The government was confronted with a completely disorganised capital market, a banking system with little liquidity, a negative amount of net investment and saving, and deplorable conditions in all government finances.<sup>3</sup> As in other areas of

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1. Medlicott, Britain and Germany, pp.3-7.

2. K.G. Robbins, Munich 1938 (1968), p.46. Robbins perhaps underestimates the strength of reaction in official quarters to the Nazi election.

3. Guillebaud, Economic Recovery, p.32.

policy, the first measures the National Socialists took in the economic sphere could hardly be described as innovatory, although it would be inaccurate to consider them simply as effective extensions of the basic strategies of the last Weimar governments.

It was largely realised at the time that the future of the Nazi régime depended on its degree of success in dealing with the desperate economic position of the country, and that the touchstone would be curing unemployment. By mid 1933 total unemployment had declined by a mere half a million from the 1932 peak of six million.<sup>4</sup> Although von Papen had attempted to alleviate unemployment by public work schemes, the fruitless policy of orthodox deflation was completely abandoned and the Nazis initiated a vigorous expansionist recovery programme. Hitler's view of economic priorities showed that the depressed state of the German economy would be something of an advantage to him: rearmament would not have to compete with other demands on labour and might for a time pass as a form of unemployment relief.

This policy therefore demanded reflation on an unprecedented scale. With Germany's reputation for inflation a further flight of capital would undoubtedly have been precipitated, had it not been for the continuation of exchange control, which became an essential pre-condition of the programme. But it was developed from being an emergency measure under Brüning to become one of the pivots of the whole system.<sup>5</sup> It represented a powerful instrument in the hands of the régime, assuring them of both the potential for maximum freedom in their economic policy and a means of isolation from international economic relations.<sup>6</sup>

But if Germany was to continue to employ exchange controls, the implications for international trade and above all international debts remained serious. Thelwall was warning as early as the beginning of February that the 'Nationalists' were in favour of reducing interest on the national debt by one-sided action, and that fear of default would not restrain the Hitler-Hugenberg régime from putting into practice their autarchical schemes. The effect on Britain, it was thought, would be further to reduce exports to Germany. In the Foreign Office Ashton-Gwatkin already considered that this refusal to play in international trade was one of the most important factors in the European situation.<sup>7</sup>

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4. B.H Klein, Germany's Economic Preparations for War (Cambridge, Mass.), p.3.

5. Arndt, Economic Lessons, p.157.

6. Ellis, Exchange Control, p.40.

7. FO 16693 C1188.

The British financial community was also immediately made aware of the changing conditions. The National Socialists were barely in power before the next scheduled round of discussions between Germany and her Standstill creditors commenced in Berlin. The British representatives, R.H. Brand of Lazards and F.C. Tiarks of Schröders, received their first taste of negotiating in the new political atmosphere. The secretary of the Joint Committee, Holland-Martin, cabled instructions on 3 February. He feared that the Clearing Banks would object very strongly to any reduction in the cash advance interest rate below 5 per cent (particularly as the average rate London was charging Germany for cash advances and acceptances was estimated at under  $3\frac{1}{2}$  per cent). The banks did not want to charge foreigners lower rates than the minimum 5 per cent paid by British nationals.

It was the Midland Bank, the largest of the contemporary clearers, which tried to resist this trend. The Bank felt that it would result in placing foreign debtors, who would not be immediately able to fulfil their engagements, at an advantage compared with many English commercial borrowers. On 24 February the Midland's Chief General Manager, Frederick Hyde, wrote to Holland-Martin saying that the Bank could not feel justified in accepting the schedule as it had been revised, and that it was not prepared to do so.<sup>8</sup>

It was left to Brand, returning from Berlin after three weeks of negotiating, to explain to the Midland how the creditors' representatives had finally unanimously agreed to the revised schedule, and to defend the delegates from the charge that they had "bounced" the London bankers into the new agreement. Brand's reply exhibited a mixture of optimism and realism. It was his hope that the creditors might, in a year or two, dispense with the Standstill; everyone wanted it to end as soon as possible.

Yet, he continued, it had its advantages. It enabled creditors to present a united front and avoid being brought individually under the German Emergency Decrees. Instead, they enjoyed the guarantee of the Goldkontbank. Brand pointed out that the German authorities had in recent years provided a good many hundreds of millions of Reichsmarks to maintain not only German industry, but also the great banks, to whom the Midland among others, gave credit. He also felt that had it not been for the Standstill, even less exchange would have been provided for interest and commission on banking debts. As far as comparative rates were concerned, he pointed out that German industrialists ended up paying higher rates than their British counterparts because of German bank commission.

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8. MB 30/190.



Above all, Brand believed the Standstill to be a set of compromises, self-evident to anyone who attended the meetings. The interests of the creditors were dissimilar. The Swiss, Dutch and English were not so anxious for a reduction in outstanding credits as they were to avoid any reduction in interest rates. The Americans, on the other hand, regarded a reduction in credit lines as absolutely vital to them and were willing to agree to a reduction in rates, if necessary, to obtain it. Brand claimed that the reductions proposed affected London to a considerably lesser degree than any other centre.

It was, of course, a compromise between the creditors and debtors. Brand thought that it was irrelevant to introduce the fact that the German credits "were not being paid". He wrote that he recognised as clearly as anyone the German risk, and from that point of view, considerably higher rates would have been justified. But the German situation was quite "abnormal"; the transfer problem could not in any way allow rates comparable to the risks involved.

Yet this was not the most important reason why the Standstill represented a compromise. Brand felt that all the delegates were aware of the political situation and regarded the minimum reduction made as some insurance against the dangers of governmental interference. Although Brand makes no mention of what he thought future premiums might be, he noted, somewhat ominously, that "very powerful interests in the new German Government have opinions about interest rates and foreign debts decidedly different from those of bankers, and there seemed a considerable risk for the future in our adopting a completely uncompromising attitude". He therefore appealed for maintenance of unity of banking creditors in the face of all the new political elements in Germany. His regret was that an institution of such importance and world-wide fame as the Midland should dissociate itself from co-operation with all the rest.<sup>9</sup> Of necessity, therefore, unity was indeed maintained. For the next six months the rate for cash advances and fixed loans was set at a maximum of 3 7/8 per cent.

#### i) The Nazi Attitude to Germany's International Debts.

These negotiations formed the first semi-official contact between Britain and Nazi Germany. Those taking part were able to relate personal experiences gained in the new Germany. One idea, which grew up and was held until shortly before the outbreak of war, was that the course of events depended on the degree of restraint the 'moderates' could continue to command over the 'extremists'.

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9. *ibid.* Memo. by Joint Committee.

Men like von Neurath and Schwerin von Krosigk (Finance Minister) appeared to fall very much into the former category.

But in order to finance vast schemes of rearmament there had to be a drastic change in the policy of the Reichsbank. Dr. Luther refused to extend the Bank's credit over Rm100 milliard - the legal limit of the Reichsbank. He was replaced by Schacht who converted a device originated by Luther, Arbeits beschaffungswechsel, into a limited credit programme by using bills drawn on an essentially dummy company, Metallurgische Forschungs G.m.b.h. or Mefo.<sup>10</sup>

In Britain there was a mixed reaction to the news of Dr. Schacht's appointment. The Treasury approved. As a former President of the Reichsbank and negotiator of the Young Loan, Schacht promised to provide a degree of continuity and respectability. He was also a long-standing friend of Governor Norman. Yet, the latter also told Luther that, "I am sad to realise that an association is now to be broken which to me (and I hope also to yourself) has been a great pleasure over recent years and in times of such uncertainty. (I) assure you that for our part we shall endeavour to maintain and further those friendly relations which you have done so much to foster".<sup>11</sup>

But Foreign Office officials believed Schacht to be prickly regarding international issues - just how prickly they were soon to find out - the colonial question was identified as a special bee in his bonnet.<sup>12</sup> Again, it was in regard to the service of foreign debt that the evidence seemed to point to a dangerously simplistic plan: through autarky the export surplus would be eliminated and the foreign creditors told that with no export surplus there could be no debt payment.

Towards the end of May Thelwall warned S.D. Waley, of the Treasury's Overseas Finance Division, that as Schacht appeared to be falling under the influence of the Nazi notion that the Dawes and Young Loan were camouflaged tribute, there was a possibility of Germany declaring a moratorium.<sup>13</sup> In the opinion of Sir Ralph Wigram, soon to be head of the Foreign Office's Central Department, the Nazis were a modern version of the old Nationalists, and their policies were to be trusted no more and probably less than those of the Nationalists.<sup>14</sup> That the Foreign Office struggled at this stage to grasp a clear picture of what the German régime was like is hardly surprising. But it was on such views of the nature of the Nazi Government that British policy had, of course, to be based.

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10. G.L. Weinberg, The Foreign Policy of Hitler's Germany. 1933-36. (Chicago, 1970), p. 30.

11. BE OV34/83, letter to Luther, 20 March 1933.

12. FO 16693.

13. FO 16695 C4949.

At the end of May the foreign creditors were once more summoned to Berlin for the next round of talks. Schacht gave the first intimation of the possible course of events. He argued persuasively that Reparations were the cause of Germany's indebtedness, telling the creditors that the Reichsbank had been put hors de combat by the scale of transfers. Although Schacht attempted to conduct the negotiations in an objective fashion, his slick tactics were already becoming obvious.

On 7 June the Reichsbank issued a statement which claimed that in the last resort international debt obligations could be fulfilled only through the movement of goods and services.<sup>15</sup> Two days later the Reichs Government announced a moratorium from 1 July on all public and private long-term debts contracted before July 1931. Thus only a few days before the World Economic Conference opened, the greatest single item was added to the list of international defaults, to complete a picture of mounting tariffs, and an international monetary system fragmenting into different blocs.

The suspension of payments on the Dawes and Young Loans was considered the most serious point. Pinsent reported that the moratorium was being regarded in Nazi circles as triumphantly giving effect to their old view that 'tribute' had to be ended.<sup>16</sup> But prompt threats by creditor countries to impose a compulsory clearing system soon forced a compromise. The Transfer of full interest and sinking fund payments of the Dawes and of interest on the Young Loan was continued; payments of sinking funds on all other loans were suspended.<sup>17</sup>

By means of the 9 June law a Konversionskasse was created, into which the debts were to be paid, and the Reichsbank was to undertake transference from time to time. In respect of the non-transferred interest quotas, the foreign creditors received scrip, which in turn they could sell to the Goldskontbank for foreign exchange. But the bank was only willing to buy the scrip at 50 per cent discount. The other 50 per cent was to be earmarked by the bank to subsidise exports, from which it was hoped foreign exchange reserves would be increased.

A few days later the British Long and Medium-Term Creditors Committee was formed to represent Britain on the International Committee of German Creditors. Sir Arthur Worley, of the British Insurance Association, was appointed chairman

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14. *ibid.*

15. FO 16696 C5106.

16. FO 16696 C5438.

17. Guillebaud, The Economic Recovery of Germany, p.63.

and Tiarks and Sir Edward Reid of Baring Brothers, representing the London Issuing Houses, were deputed for the Berlin negotiations.

Whitehall monitored these and other economic events with utmost concern. Vansittart brought out the dilemma facing officials in a mid-June memorandum entitled, 'Political aspects of German economic revival'. He recognised the danger of the Nazis being driven to adopt more and more extreme and experimental methods to maintain themselves in power.

But from the political standpoint any too rapid increase in German prosperity might also have entailed serious dangers. There were psychological factors to consider. Hitler's magic, Vansittart wrote, had already transformed the German outlook. What else, in the field of foreign affairs, might it not be expected to achieve? Frontier revision? Mittel Europa under German control? Return of the colonies? In typical Vansittart elegiac prose, he claimed that, "The most formidable Jericho, standing at the Threshold of the Promised Land, is the economic one. If this fortress were to appear to fall at the first blast of the Nazi trumpet, would not self-confidence inevitably become over-weening?".<sup>18</sup>

Vansittart was afraid of facilitating "Teutonic hubris". Germany would have to learn to co-exist with other nations and be dissuaded from rearming either overtly or secretly. These political factors needed to be considered when estimating how justified Britain was in easing Germany's economic and financial difficulties, which the Nazis were seen as trying to magnify. Vansittart's opinion was clear: the Nazi Government intended to use prosperity to rearm and so undermine international security. His memorandum was circulated to the U.K. members of the Economic Conference.

These sentiments were echoed at the beginning of July by Ashton-Gwatkin. He believed that if the National Socialists were successful in their political and economic unification of Germany, they would enjoy a strength no preceding German government had ever enjoyed. This might have tempted them to adopt a truculent and aggressive policy in foreign affairs. Besides, the statistics indicated that Germany should have been able to make all her interest payments. Instead, she was going to "come to the Conference as a sturdy beggar".<sup>19</sup>

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18. FO 16696 C5456.

19. *ibid.* C5931.

The Treasury also felt that from a financial point of view Germany's behaviour had become unseemly. It was asserted that Schacht was exaggerating the difficulties of his position. He had given only a partial picture when he suggested events beyond Germany's control had brought reserves so low. Instead, errors in Germany's past policy were blamed.

It was believed that the bondholders could plead with justification that German credit had been gravely impaired by the actions of the Reich Government. Propaganda against Reparations had led to a flight of capital; Brüning had shaken confidence and precipitated the crash of 13 June; market recovery had failed to take place because of wild utterances before, and continued agitation after, the Lausanne Conference. Evidence was also to hand to show how by threatening default, Germany depressed the prices of her bonds and then allowed foreign exchange, which should have been used to meet the service of her debt, to be used instead to buy up the bonds at knockout prices. The conclusion had to be, the Treasury told the Foreign Office, that Germany, having successfully obtained the reduction and final disappearance of all but a token payment for Reparations, and the freezing of her short-term debt, now sought to default on her long-term debts.<sup>20</sup>

But according to the Treasury Schacht was, nevertheless, aiming to conserve the Reichsbank's resources and to build up a position which would restore the confidence of short-term lenders. As London was particularly interested in short-term commercial credit, his policy had considerable support in the City. The Treasury therefore advised against pressure being put on Germany.

Sir Orme Sargent, who became an Assistant Under-Secretary in the Foreign Office in 1933, believed it was necessary to take a stronger line and was disappointed with this "spineless attitude". He realised how Schacht had cleverly propitiated the short-term creditors (banks and finance houses), to isolate the long-term ones (the mass of private bondholders), to prevent a common front. Indeed, the latter were not so effectively organised nor did they have the means of retaliation; they could not, therefore, be expected to put up such a good fight as the short-term creditors.<sup>21</sup>

So the Foreign Office wanted some official action to be taken, and Sir John Simon lent his weight to the argument. He told Chamberlain of his surprise at the lack of reaction by the City and the public. He believed there was nothing the Government could do if the bondholders had agreed to a bad settlement. But the worry was that if the German Government succeeded in getting away with a moratorium of such a dubious kind, their policy in other areas might have had profound repercussions on Anglo-German relations. Simon continued, "If it is a case of using financial default as an instrument of national policy", then I feel it is somewhat unfortunate that it should even partially

succeed; for knowing the Germans as we do, we may count upon it that they will repeat the same tactic in other spheres of international policy".<sup>22</sup>

But Chamberlain would not be moved. Sargent's language reflects the growing sense of frustration in the Foreign Office. He noted that it was disquieting that the German Government had been able to incur a "fraudulent bankruptcy" without official protest, especially in concert with the French Government who were pressing for joint action. Sargent felt that although the future of Germany was so uncertain that the City as a whole was evidently not prepared to run the risk of calling Schacht's bluff, the result was that the interest of the long-term creditors had been sacrificed to Schacht's blackmail. The Foreign Office thought that a protest should have been made on general political grounds regardless of the wishes or even interest of the City.<sup>23</sup>

The argument over the wisdom of making such representations is one example of the rivalry which existed in the delimiting of areas of official competence. The Treasury informed the Foreign Office that Sir Frederick Leith-Ross wished to fall in with Vansittart's views, but that the Governor had imposed his veto, saying that a decision against diplomatic action had already been taken. The Foreign Office reacted angrily. They felt it was a matter for the Cabinet, not the Governor, to decide. Vansittart himself much resented "this attempted autocracy in matters of high international policy". He replied to Leith-Ross asking for support in the idea of making a protest, for it "would moreover be in accordance with the general line of our present policy towards Germany and would, I think, reinforce that policy".<sup>24</sup> The idea was to discourage the belief that Britain was indifferent to the non-observance of financial or political obligations undertaken. Nevertheless, the issue was postponed and no action was taken.

Another reason why there was a marked reluctance to directly challenge events was the opportunity afforded by the BIS. The Bank of England deprecated intervention on the issue because the BIS, or in other words Montagu Norman, was discussing the question with Schacht.<sup>25</sup> On another occasion (a German proposal to alter the Reichsbank law), the Overseas Finance Division of the Treasury recommended that the right policy was to avoid getting into a first class quarrel over the question and to leave it to the BIS.<sup>26</sup>

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20.T 160 465 8797/01,Memo.by SDW,19 June 1933;FO 16696 C5584.

21. FO 16697 C6025.

22. ibid.C6046,letter,5 July 1933.

23. ibid.C6493.

24. FO 16697 C6691.

25.T 160 465 8797/01,FLR to Vansittart.

26. FO 16699 C8678.



ii) The Anglo-German Trade Treaty.

By the summer of 1933 there was, however, a distinct worsening in the Anglo-German climate. In most parts of British society there was a growing political antipathy for the new régime and its policies, particularly those relating to Austria and the Jews. Some of these unsavoury aspects of National Socialism received extensive coverage in the British press. Judging by the number of Parliamentary Questions at this time the public reaction was probably greater than the Government might have wished. Yet it is doubtful whether any fundamental shift in public opinion took place at this stage. One interpretation claims that the new Germany was held to be an alien, and as far as Britain was concerned, relatively unimportant society.<sup>27</sup>

To set against this it is instructive to turn to a contemporary source. W.F. Crick was manager of the Intelligence Department of the Midland Bank, and was later to rise to a senior management position. He wrote a report for the bank of a visit to Germany in September/October 1933. Common to many at the time Crick believed that the success of the régime depended on its economic success. The rebirth of national self-respect was seen as the major contribution of the Nazi Party to economic success. But what of the future? Crick thought some highly protective trade policies and advanced monetary experimentation might be in store which "might conceivably involve much more drastic treatment of external debts than has been undertaken up to the present".

Moreover, he warned that the German bankers feared that they would be turned out for a more radical alternative if the economic position did not improve. Crick could not imagine that autarky was to be the key note of long-term policy. He noted that a German revival would have made British traders anxious, but against this had to be set the "unquestionable facts" that a prosperous Germany was the best possible foundation for prosperity in other parts of Central and Eastern Europe. Only by increased net exports of goods could Germany have resumed the full service of her external debt. City bankers, at least, could not have remained unaware of the economic implications of Nazism presented with analysis such as this.<sup>28</sup>

As the ostensible reason for inaction over the problem of the bondholders, the Government called into question the legality of governmental intervention in an area such as this. But it was content to see the short-term creditors gain some satisfaction for themselves, even if the long-term creditors suffered, not because it favoured the financiers at the expense of the individual investor, but because there were other broader considerations. These financial negotiations have to be interpreted within a framework of the overall economic relationship between Britain and Germany.



In 1933 the National Government attempted to revive lagging exports. Apart from protecting the home market tariffs had given Britain a strong negotiating position; a series of bilateral trade agreements with foreign countries, which enjoyed particularly favourable balances of trade with the U.K., were to be concluded in succeeding years.

Concessions for British exports were gained by mere promises by Britain not to increase duties or reduce quotas. In agreements concluded in 1933 and 1934 with the Scandinavian and Baltic states, the most important concessions gained by Britain were minimum quotas for her coal exports, set at levels considerably higher than those prior to the agreements. Minor agreements were concluded with France, and in April, with Germany. But in both cases Britain enjoyed no markedly superior bargaining power.

The Anglo-German trade treaty was criticized in the House of Commons on the grounds that it had lowered tariffs to German imports without adequate consultation with British businessmen.<sup>29</sup> Some tariff reductions were granted under the terms of the other treaties. But, in the words of Arndt, the agreement with Germany "was actually the only instance before the Anglo-American Trade Agreement of 1938 of substantial reductions in duties made by Great Britain."<sup>30</sup>

In return for providing this stimulus to German exports Britain gained stabilization in the progressive reduction in the quota allocated to British coal imports to Germany. Under the agreement Germany agreed to take not less than 180,000 tons per month. But the value of coal exports as a proportion of total exports remained below the pre-1931 level.

British exports to Germany in £000's.<sup>31</sup>

	1930	1931	1932	1933	1934
Coal	3,421	2,518	1,518	1,552	1,713
Total Exports	26,808	18,411	14,574	14,711	14,011

In one sense a substantial German export surplus was actually prevented by policies of exchange control and pegging of the mark at gold parity level. The Nazis refused to devalue, probably fearing inflation and for reasons of internal prestige. At the same time, the deflation which accompanied other currency devaluations (like that of the dollar in the early months of 1933)

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27. R. Griffiths, Fellow Travellers of the Right (1980), p.9.

28. MB 30/207, Crick Report.

29. Weinberg, Foreign Policy of Hitler's Germany, p.379.

30. Arndt, Economic Lessons, p.113. See Cmd 4297, Exchange of Notes, 13 April 1933, Anglo-German Commercial Relations.

31. League of Nations, British External Economic Policies.

helped to depress world market prices. These price movements intensified the disparity between German export prices and prices for the same goods produced abroad.

Perhaps the German Government watched this trend with equanimity as it provided the necessary pretext for unilateral action in reducing the foreign debt service.<sup>32</sup> Schacht never tired of repeating that Germany's ability to pay her debts depended on a balance of trade that was favourable. The creditor countries were blamed for not importing more. The selective depreciation of securities held by foreigners was one of the methods chosen by Schacht in his attempt to find a counter-measure to the foreign devaluations.

If British officials were responsive to these arguments and considered the Reichsbank's policies with understanding, if not sympathy, it was because it was accepted that British policies were a significant factor in limiting German exports. At the beginning of July, Rowe-Dutton of the Treasury informed Vansittart that while Britain's announcement that it was considering a punitive Clearing Office had contributed to the international pressure which had forced Germany to compromise on the issue of the Dawes Loan repayments, it was considered that the balance of trade was such that a clearing arrangement would not have been worthwhile. This was a result of the drastic reduction of German imports to Britain following the imposition of tariffs. For the same reason the Treasury felt that any protest to Germany would be ineffective: Britain did not possess a suitable weapon.<sup>33</sup>

Officials were also fully aware of the implications of Schacht's policies. It was thought that the Reichsmark certificates, which were supposed to account for 50 per cent of the interest on long-term bonds, were to be bought up at 50 per cent of face value, the difference being used to subsidise 'additional exports' from Germany. These Zusätzliche Exports were broadly defined as those export goods priced at levels as low as possible and yet still more expensive than the same goods produced outside Germany. The Federation of British Industries received complaints about how the scheme would enable German exporters to gain their Government's assistance "to hit us below the belt and to defeat our tariffs". But neither the FBI nor Board of Trade seemed overly concerned by developments because German exports did not, at this stage, appear to have been rising. <sup>34</sup>

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32. Ellis, Exchange Control, p.60.

33. T 160 465 8797/01.

The British Government was placed in a difficult position. As Waley pointed out, whatever system was adopted there was certain to be a big outcry against German currency dumping. While he thought the Government had to admit that this form of dumping would prove injurious to British interests, he did not think that a diplomatic protest could be made against the proposal after what had happened in the case of the dollar and the pound. 35

This view was obviously supported by the banking community. Tiarks even went so far as to declare that it was Britain's depreciation which had seriously jeopardised the transfer of sterling by Germany to meet her obligations to investors and bankers. He advocated that the small detriment to British manufacturers caused by the very limited competition through the use of Registered and Sperr marks should be overlooked. Such competition, Tiarks continued, would really only become effective if Germany followed the example of Britain and America, and similarly reduced the value of her currency. A tariff and currency war might then ensue. 36

There was indeed a steep difference between the Gold Standard pound exchange rate of 20 Reichsmark and the rate in November 1933 of just 13.37. The effects of sterling's depreciations were emphasized in the report by Crick. It was difficult to convince a German, he wrote, that depreciation did little or no more than express the true relation between prices and costs, since sterling had been over-valued from 1924 to 1931. Crick outlined how there were, in effect, three different currencies in use in Germany: one for internal business, one for imports, one for exports (of which perhaps one fifth of the trade was paid for in discount marks and approximated the true value of the mark). There appeared to be agreement in Germany that in any general monetary stabilization there would be no difficulty about a once for all devaluation of the mark but that a fluctuating gold value would be disastrous. It is doubtful whether devaluation would have made a great deal of difference. Certainly Crick saw little hope of a substantial recovery of export trade until sterling and the dollar found a new degree of stability in terms of gold, or until the French were driven off gold. 38

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34. T 160 642 8797/04/1.

35. *ibid.* Memo. by SDW, 9 Aug. 1933.

36. *ibid.* Memo. by Tiarks, 'Zusätzliche Exports', 30 Aug. 1933.

37. Financial Times, 21 Nov. 1933.

38. MB 30/207.

The Bank of England too was ready to defend the German actions. It indicated four ways in which, whatever the foreign creditor or industrialist may have thought, the Konversionskasse and Zusätzliche Exports had their uses from the point of view of the debtor. These were: a) some payment of interest on foreign loans was made possible; b) the Reichsbank could acquire additional reserves of Devisen; c) the volume of exports was increased and thus volume of employment; d) benefits of currency depreciation in promoting exports were secured with limited publicity and a great appearance of bona fides.<sup>39</sup>

Even the Foreign Office were surprised that there had not been louder and more sustained complaints about British commercial policy, which, Aston-Gwatkin claimed had probably hit Germany harder than any other country. He considered that tariffs generally had been extremely severe on German products, with Ottawa damaging German trade with the British Dominions, and the Scandinavian treaties aimed at supplanting German goods with British. The minute concluded, "The measure of success had been the diminishing German export trade, upon which the payment of money lent by the U.K. to Germany depends. It is an extraordinary circle".<sup>40</sup>

What the Foreign Office wanted to know was how Hitler's foreign policy would be influenced by the absence of economic recovery. The question remained whether failure in this area was going to force Hitler into a more spectacular foreign policy for the purpose of diverting popular attention from troubles at home. Sargent wrote to Phipps that, "We are faced with two theses, and the question is which is the right one? On the answer we give will largely depend the future policy of H.M.G. toward Germany". He reminded Phipps that their "Bible" on the real nature of the Nazi revolution remained an earlier despatch by Rumbold, which certainly supported the thesis that Nazi peace protestations were a façade behind which old forces were re-grouping.<sup>41</sup>

Nevertheless, the Foreign Office were also keen to get Hitler's signature to an agreement while he continued in a peaceful mood, even if the circumstances were not favourable to Britain. This fundamental trait of British policy at this time is evident from the rather low-key reaction to the news that Germany was to leave the League of Nations and Disarmament Conference. Simon and Eden were generally supported in their attempts to develop a policy which appeared understanding and sympathetic, in order to win Hitler over to an agreement. It was hoped that this would also create a climate for an economic agreement.

Vansittart agreed with the necessity of this, but was also sceptical as to Germany's real and ultimate intentions. Judging by the militarism and bitterness which he saw in Germany, he doubted whether Hitler would be faithful to

his signature. Simon also did not believe in the peaceful intentions of Germany in the long run (unless, of course, everything that was being demanded was granted). But he considered it was a case of striking a bargain, even a bad one, "before the iron gets too hot".<sup>42</sup>

iii) The Crisis over Germany's Foreign Bondholders.

In the autumn of 1933 a critical turning point developed in Anglo-German economic and financial relations. Information began to filter into London that the Dutch and Swiss creditor representatives were negotiating separate agreements with the Reichs Government, whereby creditors would receive payment of their scrip in full, so long as the final 25 per cent was covered by additional German exports to these two countries.

In spite of denials by Schacht over the summer, separate agreements were concluded by mid-October. The united front of the creditors was broken. But most significantly of all, preferential treatment was contrary to Schacht's promises, and the British bondholders felt it was a clear act of discrimination against them. With British interests seemingly receiving a double blow, the bondholders now asked for an official protest to be made.

The press also took up the call. The Financial Times vilified Schacht for breaking his promise to treat all creditors as equal, calling it a "fraudulent preference" of an unprecedented kind. Discrimination against the U.K. was particularly unfair not just because of the volume of imports from Germany, but because the London loan market was the "indulgent milch cow at the time when Germany was under-nourished". Urging the government to take action, the article pointed out that Germany's favourable balance of trade was a little treasure which she would not willingly expose to blizzards.<sup>43</sup>

Not everyone agreed with these ideas. The Governor was opposed to any action being taken. Meeting the Treasury high officials he claimed that, from the point of view of Dr. Schacht, the whole episode was a regrettable necessity. Norman also thought that a stalemate would arise if as a result of a protest the German Government offered Britain an agreement similar to that accepted by the Swiss and Dutch. He certainly did not approve of the alternative, namely the threat of imposing a clearing arrangement.

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39. T160 642 8797/04/1, Bank of England Memo. 6 Sept. 1933.

40. FO 16700 C9561.

41. FO 16728 C 9489. Sir Eric Phipps replaced Rumbold in 1933 as British Ambassador in Berlin.

42. FO 16729 C10268.

43. Financial Times, 10 Oct. 1933.

Norman also reminded the Treasury that the bondholders were particularly anxious that the form of intervention would not prejudice the advantages already secured for British creditors, especially those relating to the Dawes and Young Loans. The Treasury was indeed worried that Germany was capable of interfering with these arrangements which were considered perfectly satisfactory. But it was also recognised that a protest had to be made. There were future negotiations to consider; City and press opinion had to be taken into account; not least, a real principle was perceived to be at stake, namely whether a debtor was entitled to barter fulfilment of obligations against new trade advantages for himself.<sup>44</sup>

The protest was not, therefore, to be violent or couched in terms which might have embarrassed Britain if an impasse was reached. Or, as the Foreign Office noted, the protest was par la forme only, for domestic public and parliamentary consumption. It was to be pointed out that Britain already took 'additional' exports from Germany; the government had always refused to control the volume, leaving it to individual buyers' actions dictated by normal economic motives.<sup>45</sup>

The Foreign Office despatched instructions to Ambassador Phipps on 7 November; the protest was accordingly lodged with the German Government.<sup>46</sup> No doubt the diplomats supported this development enthusiastically. The full implications of the scrip scheme were beginning to sink in. Phipps reported that it did not only mean dumping, but dumping subsidised out of a fund provided by the foreigner - a proceeding hitherto unknown in international trade - and that it was rumoured that the United States Government was to impose an anti-dumping duty. Pinsent also expressed his frustration. He "confessed" that in the last desperate resort brutal measures such as discriminatory tariffs might prove the only way to move the Germans, even though that option was debarred under the 1924 Anglo-German Commercial Treaty.<sup>47</sup>

British officials could not compute the exact amount of subsidy made available by the German authorities for their exporters, although it was believed to be small. The Bank of England suggested that this was just what British traders did not like about the system. They could not tell what form of competition or the extent of the disadvantage to which they were exposed. A rash

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44. T 160 642 8797/04/2, note of Norman/Hopkins meeting, 17 Oct. 1933, and min. Phillips to Hopkins, 28 Oct. 1933.

45. FO 16700 C9637.

46. DGFP, Series C, Vol. II, Doc. 103, p. 179-80.

47. T 160 642 8797/04/3, Phipps to Simon, 31 Oct. 1933, and Pinsent to SDW, 9 Nov. 1933.



of complaints was beginning to come in from the FBI and the National Union of Manufacturers.48

The Bank also indicated that the assistance being given to German exporters to enable them to obtain cheap marks was no new departure; it had started before Hitler. But there were new features such as an increased supply of even cheaper marks and a simplified procedure which enabled German exporters to negotiate undercutting transactions. Scrip marks added to the already large reservoir of blocked marks, such as Sperr marks frozen under exchange regulations, and Register marks arising from the Standstill.

With the bondholders scheduled to meet in Berlin on 5 December an inter-departmental meeting, under the chairmanship of Colonel Colville of the Board of Trade, was held on the first of that month to consider British policy. It emerged from the meeting that British industry had been told that the cheap marks procedure, which amounted to a partial depreciation of the currency, was less harmful to U.K. trade than a general depreciation would have been.

In the opinion of Leith-Ross Germany, since 1931, had adopted the alternative method of deflating costs and had succeeded in doing so to an extent nearly equivalent to the U.K.; in addition, assistance to exporters by partial depreciation was an objectionable form of trade competition. He was in no doubt that Britain would probably need to raise the stakes by threatening a clearing in order to get the full 100 per cent on the scrip. As Germany needed British re-exports Leith-Ross did not foresee any cancellation of imports by Germany.49

The discrimination between creditors was at the heart of complaints made by the British representatives at the meeting in the Reichsbank. Schacht maintained that as President of the Reichsbank he was simply following his government's instructions in executing agreements which Schmitt, the new Minister of Economics, had negotiated. He also claimed that separate agreements with the Swiss and Dutch had been forced on Germany by threats of clearing arrangements. For their part the British delegates made it plain that they would enlist the further support of the British Government, if they could not gain Schacht's agreement to terms no less favourable than those they had previously negotiated, especially as the statistics seemed to indicate a slight improvement in Germany's economic position. The Reichsbank hinted that there was a need to reduce interest rates further and merely indicated that a statement would be issued before the end of the month. The representatives returned to London frustrated and annoyed.50



While British officials considered whether it was possible to influence the Swiss and Dutch creditors to end the separate agreements, or whether such action would simply have been playing the Reichsbank's game of setting one creditor against another, the new arrangements announced by Schacht on 18 December sent shock waves through Britain. The plan was to reduce the free exchange element of the debt service from 50 to 30 per cent.

The Foreign Office, however, was not so surprised. Perowne (First Secretary), expressed the view that the arrangements made in the summer had been just as unilateral. He remarked, almost superciliously, that in the City there was now a new and painful realisation of the nature of Dr. Schacht's schemes. He felt that the City had not been alive to what had been afoot when they had so complacently accepted the arrangements laid down before by Schacht and tacitly acquiesced in by the bondholders' representatives at that time. Perowne also noted that there was a disposition to try to blame the Foreign Office for the failure to protest, but, "our efforts were defeated by the determined opposition not only of the Treasury but also of the bondholders themselves".<sup>51</sup>

Sir Frederick Leith-Ross held that Schacht's "latest outbreak" should have disillusioned anyone who still believed in German commercial honesty. He felt that Germany was able to meet all its interest payments but was instead concentrating on building stocks of war material such as nickel and copper. The Government had, therefore, to consider more effective means of pressure, such as a clearing or prevention of short-term credit, to ensure that the German authorities met their obligations to the fullest possible extent. Moreover, the Stock Exchange was reporting that German nationals were buying up bonds at depressed prices. Finally, Sir Warren Fisher concluded, it was best if Britain showed it had teeth and would use them.<sup>52</sup>

Leith-Ross told Tiarks that he would like to have seen all the London financial interests join together and tell Schacht that he had to come to some arrangement satisfactory to the creditors without discrimination, or London would be compelled to withdraw every sort of credit from Germany as quickly as could be done and that no renewals could be entertained. Leith-Ross realised that this would be awkward for the short-term creditors, but he warned that their turn might come next and that they should therefore be solid with the long-term creditors. But Tiarks believed that decisions had been taken over Schacht's head and it was thus unfair to blame him for what was a political question. Threatening to end the Standstill agreement would, Tiarks maintained, have no effect on credits as they were all locked up, and transfer restrictions prevented the creditors from getting their money back. They could, of course, refuse to accept bills; this would mean going under cash advances as



the bills matured thus forcing the acceptance houses to obtain advances from the Bank of England. Tiarks ended by pointing out that the difference between short and long-term creditors was that the former had accepted a 50 per cent reduction in charges for interest and commission since 1931.<sup>53</sup>

In the Bank of England Professor Clay, an Adviser to the Governors, postulated that the alternative to Germany going off the Gold Standard was a partial default on long-term debts. Britain could not object to this in principle, unless it could be proved that Germany could find the necessary foreign exchange, as the progress of recovery depended on the writing down of debts. But by reducing payment to long-term creditors and then subsidising exports, Germany had created a conflict between the different types of creditors. Worse still, Clay claimed, the German Government had created a monopoly in scrip and was discriminating between countries. The effect would be to depress prices internationally and to arm German industry with a gun that could go off at any time and in any direction.<sup>54</sup>

Although its effectiveness was doubted a further protest note was presented by the Government on 22 December. The Press added to the storm of protest. On New Year's Day 1934 the Manchester Guardian claimed, "It is one of the British Government's objects to force the Reichsbank either to reverse its policy or to face the proof of its political motive."<sup>55</sup>

Anglo-German relations had thus turned very cold. But the Government's protest was restrained, merely expressing surprise and regret at the Reichsbank's unilateral decision. Failure to observe the principles of negotiation, it stated, would tend to undermine the credit of Germany as a whole, and would make it increasingly difficult to maintain international credit operations on which the financing of commerce largely depended.<sup>56</sup>

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48. *ibid.* Bank of England to SDW, 28 Nov. 1933.

49. T 160 642 8797/04/4.

50. FO 16702 C11123.

51. *ibid.* C11241.

52. T 160 642 8797/02/1; T 160 642 8797/04/5.

53. BE 0V34/195, letters, 28 Dec. 1933 and 29 Dec. 1933.

54. BE 0V34/195.

55. Manchester Guardian, 1 Jan. 1934.

56. FO 16702 C11241.

Noticeable in this démarche is the importance attached to international finance, of which London was, of course, the world centre. Stopped debt repayments placed this role in jeopardy, and it was the business of the financial institutions to try to keep foreign operations continuing along normal lines. The City attempted to act as a stabilising force and to prevent extreme measures of retribution against Germany. It was thought that clearing arrangements or import controls would disastrously disturb normal trade and credit channels.

Germany enjoyed a favourable balance of trade with Britain. A unilateral clearing arrangement could, therefore, have required the debts owed by British importers of German goods to be paid to a clearing office in London. British creditors (both financial and trade) with claims on Germany, would then have received settlement from this office, with the balance being remitted to Germany in sterling. A bilateral scheme would have operated with the co-operation of the German Government.

The Secretary of the Joint Committee, Stopford, told the Treasury that there was concern over the threat of a clearing against Germany and its likely effect on the international character of the Standstill. He complained that the creditors had not been consulted but confronted with a fait accompli; they were being asked to approve a measure (of which they disapproved), because they held a weapon in the form of stopping short-term credit to Germany. Stopford thought that very little business was being done in any case, and that such amazingly good terms were being offered by Germany that the need must have been great and the supply very limited.<sup>57</sup>

Stopford also informed the Foreign Secretary of a growing fear in the City of German intentions to declare a general moratorium on all British financial claims in the event of a clearing. He then outlined how grave the ramifications would be for the Standstill creditors, particularly the acceptance houses on whose accounts the bulk of the availments were. Commitments had declined from the original £65 million to £54 million. Actual availments totaled £43.6 million. While £10.4 million had been repaid, under the terms of the agreement it was held open for re-drawing if desired.<sup>58</sup>

Perhaps another aim of the Standstill creditors in emphasizing the international function of London's financial machinery was to try to take the wind out of the sails of those, like the Foreign Office, who reproached the City for acting against the interests of ordinary British citizens. Pinsent reported that the Nazis were drawing disproportionate attention to the existence of groups in the City, "presumably Tiarks and his friends", who did not regard the Nazi régime and Germany's behaviour over foreign debts with an unfavourable eye.<sup>59</sup> Although financial transactions with Germany might have been in the interests of Britain's

foreign trade and credit, there was talk that these interests should have been relegated to ensure that British prestige was not damaged.

The Foreign Office thought it had a clear idea of what constituted the national interest. The Berlin Military Attaché had no doubt at all that Germany's demands for equality of armaments were only a step towards further expansion, but that the financial position would postpone that phase no less surely than any convention would.

This, for Vansittart, was the all important point. Writing candidly to Fisher he stated, "I have always thought that financial stringency in Germany was going to be our principal safeguard against wholesale German re-armament, and that we should do all we can to keep Germany financially lean, even at a cost to certain people here." Vansittart hoped that any future lending to Germany would be limited to the short-term for strictly commercial purposes. For any financing of German industry would, in the circumstances, contribute a direct incentive to the Reichswehr to press on with their rearmament schemes, held up for want of cash. Although he knew of Treasury opposition to any suggestion which might have harmed the Standstill creditors, Vansittart wanted to raise the possibility of the City limiting or withdrawing credit.<sup>60</sup>

Thus although the British Government was being increasingly drawn into the financial negotiations, the authorities failed to present a united front. In mid January Governor Norman attempted some 'behind the scenes' diplomacy at Basle. He worked out a proposal with Schacht (who had obtained Hitler's approval), that the Bank of England would find for two years the money to satisfy the long-term bondholders in respect of that part of their interest (about 35 per cent) of which they would not be able to obtain payment if the new German regulations came into force. Norman offered to carry these coupons until they were paid off by Germany. The Governor was prepared to take the risk (which amounted to £0.5million) in order to avoid a collision with Germany. Thus it was hoped that the long-term bondholders would be given practical consideration and that the short-term creditors would be relieved of their fear of the institution of a clearing and possible retaliation against their interests.

But concern was expressed in the Foreign Office that the British Government would appear as being frightened to take retaliatory action because of the

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57. T 160 642 8797/04/6.

58. T 160 642 8797/04/7, letter to Simon, 25 Jan. 1934.

59. T 160 602 8797/04/6, letter to Rowe-Dutton, 8 Jan. 1934.

60. FO 17675 C76.

threat of economic disaster in other spheres. For as no foreigner believed the Bank of England to be anything other than a department of Government, the latter would be thought of as being responsible for the scheme. Wigram posited that acceptance of the scheme would show the Germans once again that, in the last resort, the Government were always to be roulé by the pro-German bankers of the City. He could imagine no procedure better calculated to weaken British prestige abroad and to encourage discrimination against British interests.<sup>61</sup> After discussing the proposal with Fisher and Vansittart, Neville Chamberlain put forward the objections advanced by the Foreign Office (with the exception of Wigram's opinion concerning City bankers), when he told the Governor that he could not agree to the proposal.<sup>62</sup>

When the scheme miscarried Schacht reported to Neurath that Norman had referred to "political difficulties", which Schacht interpreted as meaning that the British Government was pulling back at the last minute, in the face of the hostile attitude of Parliament, and consultations with other governments involved.<sup>63</sup> Certainly Britain did not want to jeopardize relations with the United States. It was realized that America was not in a position to take any retaliatory action against Germany because the balance of trade favoured the former. But the American government had been vigorous in supporting Britain's position.

The vigorous opposition to any compromise was taken a stage further by the Foreign Office. Wigram and Vansittart took up an idea of Leith-Ross's, namely that important newspapers might well drop hints that the institution of a clearing was being considered. The news department of the Foreign Office was asked to effect this at once, in an unofficial way. Vansittart commented: "At last some energy has been shown!". He thought that it would be useful if British newspapers were as outspoken as their American counter-parts (with their references to 'fraudulent bankruptcy'), though not so unanimously as to suggest a conspiracy. The newspapers of January 1934 indicate that Fleet Street was only too happy to co-operate.<sup>64</sup>

By 18 January 1934 Sir John Simon had followed up this activity by instructing Phipps to inform Hitler of British concern over the transfer moratorium. Hitler was asked to use his personal influence to find a way out of the problem. The Ambassador was to make plain that while the British Government was extraordinarily concerned to avoid establishing a clearing arrangement, it had no choice other than to find a means of self-defence if Germany persisted in being stubborn. It was thus implied that a trade war might result unless Hitler could contribute to finding a friendly solution.

The Documents on German Foreign Policy bear witness to the reaction this evoked in Hitler, and the relationship between the problems confronting any Anglo-German agreement. Neurath replied to Phipps that Germany would not be intimidated, and that after two months at most, not even a pfennig would be transferred if the British Government continued in its demand for cancellation of the Swiss and Dutch agreements.<sup>65</sup>

The German Foreign Minister also claimed, that among other reasons, it was well known that the particularly favourable opportunity which the World Economic Conference might have afforded the debtor countries, for an international revision of the conditions of export and transfer, was missed through no fault of Germany's. Neurath continued that Germany's foreign indebtedness was not like that of other countries, the latter being the normal outcome of the development of international trade. Germany's debts were seen as resulting from the political situation of the past. The term used, therefore, was 'political debts'.<sup>66</sup>

Hitler and Neurath agreed that they could not let themselves be influenced by this new démarche of the English Government. They saw it not only as an extortion manoeuvre on behalf of British creditors, but also as a calculated move to bring general pressure to bear on them, to make them as tractable as possible particularly over the disarmament question.<sup>67</sup>

Financial and political matters had, therefore, become inextricably linked. Financial problems were both a contributory factor in producing, and result of, the political atmosphere. Finding a solution to the financial question had become an issue of primary diplomatic importance. For the British Government the way was open for a temporary settlement of the transfer question, so long as the principle of equal treatment could be respected. But officials doubted that it would be. The Foreign Office informed Phipps that the object of the creditors in Berlin at the end of January would be to end discrimination, but failing that, they were to explore the possibility of reaching their own separate agreement with Germany.<sup>68</sup>

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61. FO 17675 C315, minute Wigram to RV, 16 Jan. 1934.

62. NC 2/23A, Political Diaries 1933-36, 22 Jan. 1934.

63. DGFP, Series C, Vol. II, Doc. 204, p. 396.

64. FO 17675 C77.

65. DGFP, Series C, Vol. II, Doc. 196, p. 382.

66. *ibid.* Doc. 200, p. 387.

67. *ibid.* Docs. 193 & 197, pp. 380-3.

68. T 160 642 8797/04/7, FO Telegram, 22 Jan. 1934.

Digesting the German reply to the British notes of December Waley took exception to the idea that German indebtedness was special because so much could be attributed to the need to provide foreign exchange for Reparations. At the same time he rejected the implication that the Nazi Government had a moral responsibility to prevent repayment. The Treasury were worried, however, that if Britain imposed a clearing, Germany would default completely to the United States, hoping thereby to embroil Britain and America. In the opinion of Sir Warren Fisher, the "Norman-Schacht conversations are shown more and more to have been unfortunate .... The German attitude in this matter is merely a repetition of her historic procedure", which he dated from the time of Frederick the Great.<sup>69</sup>

Finally, however, it seems to have been the up-dating of trade figures which gave officials, at least, the resolution to act. Buttressed by the knowledge that the balance of trade in favour of Germany had stopped declining, the programme for the institution of a clearing was drawn up on 25 January. For, unless Britain's trade debts were significantly greater than her earnings from exports to Germany, there would be no point in setting up a unilateral clearing system.

TABLE 9  
Germany's Export Surplus in £000's.<sup>70</sup>

Year in quarters	Imports from Germany	Exports & Re-exports	Balance
I 1931	13,956	8,220	5,736
II	14,686	9,004	5,682
III	16,859	6,321	10,538
IV	18,650	8,478	10,172
I 1932	9,390	7,872	1,518
II	5,540	5,887	347
III	7,330	4,968	2,332
IV	8,180	6,685	1,495
I 1933	6,591	6,025	566
II	6,824	5,965	859
III	7,569	6,067	1,502
IV	8,834	6,434	2,400



Estimated Debt Service of Germany to Britain in 1934.71

	£
Standstill debt interest and commission on say £44 million .....	1,600,000
Municipal Standstill debt interest .....	175,000
Other short-term interest .....	857,000
Interest on say £60 million long-term debt held in U.K. at say 6½%.....	3,900,000
Sinking fund of Dawes Loan .....	628,000
Sinking fund of Young Loan (if paid in paper).....	144,000
	<hr/>
	7,304,000

The Treasury and the Chancellor of the Exchequer did not want general powers put on the Statute book. It was felt that this would have been contrary to what had been said at the World Economic Conference, and that the warning to other potential defaulters would be sufficient. Sir John Simon, on the other hand, felt that to draw up a bill specifically aimed at Germany was to be unnecessarily provocative.

In the event there was no need for an immediate decision on this issue. On 31 January the creditor representatives, meeting in Berlin, agreed to end discrimination from 1 July of that year. Interest payments, however, were to be transferred in the proportions of 30 per cent cash and 70 per cent scrip, as the Reichsbank had originally proposed. But instead of redemption by the Golddiskontbank at 50 per cent, the rate was increased to 67 per cent of face value.

It was realised that the settlement could only be a temporary one and that it represented a compromise, which Brand had earlier been at such pains to emphasise was the necessary position to take. But there was widespread relief that a full scale crisis had been avoided. A Bank of England internal memorandum gave the reason why the Bank had consistently opposed the idea of a clearing. None of the agreements already operating had successfully fulfilled the purposes for which it had been formed. Instead, most agreements had actually had the effect of retarding trade. The Bank had also wanted to avoid all responsibility

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69. T 160 642 8797/04/7.

70. T 160 642 8797/04/3, abstracted from Board of Trade returns.

71. *ibid.* Estimate by SDW, Nov. 1933. Nothing was allowed for invisible imports and exports as there seems to have been no reliable way of computing totals. It was imagined, however, that this balance was clearly in Britain's favour.

for running the Clearing Office because it felt that it did not have the technical knowledge required and that relations with the commercial community would be damaged.<sup>72</sup>

Chamberlain was more than happy with the result of the negotiations. He wrote to his sister Hilda that he had had an anxious time over the dispute. He thought it most dangerous for Britain to allow itself to be bullied, so he had threatened Germany with a clearing. This, Chamberlain continued,

"put the City in a blue funk and the Chairmen of the 5 banks with other magnates proposed to come and tell me of the awful disasters which might follow. But before they could come we had a brilliant triumph. The Germans surrendered on both points. They agreed to give up discrimination and abandon their claim to unilateral decisions without consulting the creditors".

Chamberlain felt that although his boldness had been rewarded with a great success of which the public might never hear, he could, nonetheless, enjoy full satisfaction in the result.<sup>73</sup>

To the officials in the Foreign Office, however, the negotiations had revealed something most unwelcome: the difficulty involved in making policy towards Germany. Wigram believed that the loans to Germany hung round the necks of officials like a millstone and he suspected that quite fresh money was being advanced to Germany. He also held that the relations of his department and the Treasury with the Bank and City authorities were in urgent need of an overhaul. Government department worked together as one machine, without official letters but by close personal contact. Wigram could not see, therefore, why the Bank of England should remain wrapped in mystery.

According to Sargent the lack of co-operation between the Foreign Office and the Bank was an old-standing grievance which the former had made repeated attempts to remedy without much success. He wrote that,

"In spite of all our efforts Mr. Montagu Norman continues to carry on his own foreign policy, certainly without consulting the Foreign Office and without, I suspect, taking even the Treasury very much into consideration. The present dispute with the German Government affords indeed a glaring instance of this independent action by the Bank of England, for the settlement which has now been reached as a result of the firm action which we were at last allowed to take was almost wrecked not so very long ago by the sudden intervention of Mr. Norman". Until some system of collaboration existed Sargent felt that the Foreign Office would always be exposed to the danger of being tripped up and double-crossed. Vansittart feared that Norman was, "a misguided though pleasant person. His methods seem to me intolerable, and I wish the country were well rid of him - though I suppose that such sentiments are heresy in his City Cenaculum. I have tried keeping in touch, but it has not worked. We must leave him to the Treasury - if they

will deal with him."74

According to Waley in the Treasury new short-term credits to Germany on a normal commercial basis had indeed been granted in an appreciable amount. But this was felt to be a healthy development as it meant that three months' credit was substituted for frozen credit. The new credits were being used, it seemed, to finance wool and wheat purchases. And although it could be said that money was thereby released for other purposes, Waley did not see how the credits could be stopped without stopping a great part of Britain's commercial machine.75

Thus in the first year of Nazi Government in Germany financial questions formed an important part of Anglo-German relations. Such questions had, of course, always provided an extra dimension to the problem which Germany represented to British policy-makers. But by the end of 1933 the British Government had been stimulated into taking serious steps in order to protect financial interests from the actions of the German authorities.

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72.BE OV34/198,Memo.27 Jan.1934.

73.NC 18/1/859,3 Feb.1934.

74.FO 17676 C749, minutes, 1-2 Feb. 1934.

75. ibid.minute,8 Feb.1934.

## CHAPTER V

The Financial Agreements of 1934.

While the first year of National Socialism gave British financial and economic interests a first taste of the changing relationship between the two countries, it seems likely that even the most pessimistic official or businessman did not foresee the extent to which that relationship was to deteriorate in 1934. That year was to prove to be particularly important. In order to avoid complete breakdowns Britain and Germany concluded official agreements which helped to define and formalize financial and trade affairs.

As Nazi economic policies began increasingly to limit the amount of free exchange available to foreign creditors, it became obvious that some form of exchange control between Britain and Germany would be necessary. Yet, in spite of fairly widespread suffering by British trade and financial interests, calls for a stringent exchange control arrangement, as practised in many other countries, or even a unilateral clearing system, were resisted by British policy-makers. Instead, towards the end of 1934, and after some failed experimentation, a more liberal agreement was negotiated. The terms of the agreement seemed to be peculiarly favourable to Germany. Moreover, this Payments Agreement was to remain in operation largely unchanged until the outbreak of war, and was, therefore, to provide a basis for economic affairs for the remainder of the decade.

The process of financial negotiation with Nazi Germany left a mark in the minds of some in Whitehall. Although a temporary settlement had been reached with the bondholders the Foreign Office was sceptical about the chances of the arrangements surviving when negotiations resumed in April. It was felt, however, that if Parliament took up general powers to impose clearing arrangements this weapon, more than any other, would help to bring the negotiations to a satisfactory conclusion.

The Treasury and Board of Trade were opposed to any such idea. There were negotiations with other countries where there was no desire on the part of Britain to threaten a clearing. The Chancellor thought that it would be impossible to ask Parliament for general powers when there was no specific case in contemplation. And if it could be shown that general powers would be of no use except for Germany the whole question fell to the ground. But the Foreign Office feared that the British opposition to a clearing system would be much more powerfully organised if the question came up later in the year. Schacht, too, would prepare the ground and be on his guard against any recrudescence of British firmness.<sup>1</sup> So the Foreign Office drafted a letter to the Board of Trade which Vansittart hoped would convince the latter that general powers should be asked for in vacuo. But at the

last moment the Foreign Secretary decided that the question could not be dealt with as a mere piece of useful and innocuous machinery: it threatened most serious domestic and Parliamentary reactions.<sup>2</sup>

Suffering a setback on this front Vansittart attempted to enlist the support of Sir Warren Fisher to bring about a change in attitude to Germany. He wondered whether Fisher supposed that the Governor of the Bank of England and the City in general fully appreciated the weighty political issues involved in their financial relations with Germany. Vansittart asked, "Have they not perhaps been rather too much guided, hitherto, by considerations of a purely commercial order - the short view in fact?"<sup>3</sup> Towards the end of March Vansittart tried again to persuade Simon to take action: the Foreign Office had a responsibility to push for clearing powers and to assemble information for use by its News Department in educating the public to the German menées. Simon, however, was still reluctant to face the task of winning over Chamberlain and Runciman to such ideas.<sup>4</sup>

In the Treasury Hopkins, in particular, continued to express his reservations about clearings. Throughout the world crisis they had been strenuously opposed by Britain on the grounds that they were injurious to world trade, especially entrepôt trade - one of Britain's greatest resources. If general powers were taken there would be continuous pressure to use them in all sorts of cases; Britain would find itself attempting to conduct foreign trade under a system of perpetual governmental interference. Clearings were thus the worst form of trade impediment.<sup>5</sup>

Another high Treasury official, Sir Frederick Phillips, disapproved of clearings for a reason which helps, perhaps, to explain one of the motives behind Treasury policy. Phillips was very conscious of the part Britain had recently played in the world economy, a part in which Britain could hardly take pride. He wrote, "No country ever administered a more severe shock to international trade than we did when we both (1) depreciated the £. (2) almost simultaneously turned from free trade to protection. Overwhelming reasons can be given why we were compelled to do these things but the point is we ought not to be too touchy at developments abroad which interfere with us."<sup>6</sup>

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1. FO 17676 C749, Sargent minutes, 2 & 9 Feb. 1934.

2. *ibid.* minutes by RV, 13 Feb. 1934, and Simon, 16 Feb. 1934.

3. FO 17677 C1232, 22 Feb. 1934.

4. FO 17742 C1590, 27 March 1934.

5. T 160 612 13460/1.

6. T 160 612 13460/2, note, 30 April 1934.

i) The Initial Threat to a Clearing.

In line with the communiqué issued at the end of January 1934, attention began to focus on the meeting to be convened in April between the Reichsbank and its long-term creditors. No one expected the negotiations to be easy. On the one hand the Swiss and Dutch creditors strongly urged their British counterparts to abandon what they regarded as sentimental objections to discrimination. They wanted the British to join with them in insisting that Germany should pay 100 per cent to all creditors who bought her goods and only cut down payments to the United States with whom her balance of trade was so unfavourable. On the other hand, the Reichsbank was suspected of deliberately engineering its foreign exchange reserves to produce timely losses. Those concerned in Britain had already come to regard some reduction in German transfers to foreign creditors as inevitable.

Treasury officials, with the support of the Chancellor of the Exchequer, decided that the best course would be to attempt to secure agreement for equal treatment of all creditors. But if, as was feared, the Swiss and Dutch insisted on retaining their separate agreements, Britain would insist that it was treated just as well by the German authorities and would make clear that in no circumstances would discrimination against British creditors be tolerated. Sir Warren Fisher added force to these arguments. He pointed out that not only did Germany enjoy a favourable balance of trade with Britain, but, according to a CID paper on foreign countries' purchases of raw materials used in the production of war munitions, German purchases of this character were specially heavy, though not necessarily disclosed in their custom statistics.<sup>7</sup>

When the representatives of the Long-term Creditors Committee met in Basle, it was to find that the position of the Dawes and Young Loans was threatened. The British Government was once again thrown on the defensive. In the opinion of Pinsent at the Berlin Embassy, while Britain could expect special treatment corresponding to that received by the Swiss and Dutch, (because of the volume of her imports), it would be necessary to secure this by special agreement in which creditors would have to be content with less than 100 per cent. A blind eye could also be turned to suspension of the Dawes sinking fund.<sup>8</sup>

But rather than waiting to react to events in Germany Chamberlain wanted to take immediate action. The Foreign Office was informed that in the Chancellor's opinion the right course was to send a démarche to Berlin to the effect that the Dawes and Young Loans should not be subject to a transfer moratorium.<sup>9</sup> The Chancellor was keen to indicate to the British creditors the

importance the Government attached to these two loans, but at the same time he did not want to suggest the possibility of any clearing being imposed.

By the end of May it was becoming clear that the Dutch and Swiss were going to insist on a firm cash offer for the funding bonds held by their nationals. The Treasury considered that if those creditors were ready to accept 80 per cent, then the British creditors might be content with 70 per cent. But if the Swiss and Dutch were forced to erect a clearing, the Britain would follow suit and preparations would have to begin. Leith-Ross despaired of German policy which he admitted he found difficult to understand. In his view it was necessary for Germany to be committed to paying its Reich loans in full, to fund other loans and to refuse special concessions to particular creditors. If these obligations were fulfilled then the whole international situation would ease and German credit would at once improve. If they remained unfulfilled then Germany would be faced with clearings all round which would bring disaster to the country's economy and perhaps to the Hitler régime. Leith-Ross commented that he, for one, deprecated such a course of events.<sup>10</sup> He thereby implied that he believed (along with many in Britain in the 1930s), that if the stabilising influence of Hitler were removed, central Europe would fall to Bolshevism and international economic collapse would follow. Nevertheless, he wrote to Montagu Norman to say that it would be helpful if City bankers could impress on their German friends that it was no bluff that failing satisfaction a clearing would be imposed.<sup>11</sup>

Eventually Chamberlain too saw the need, "to show the Germans that this country means business and that we are resolved to take measures to defend our interests if our wishes are not met." Unfortunately, as 1934 progressed, opinions of what constituted Britain's interest began to differ considerably. But by early June the Chancellor had approved the setting up of an Anglo-German Clearing Office. Yet he wanted to obviate what he saw as the unpleasant necessity for separate legislation for the case of Germany, by including the latter in a general bill then being drafted.<sup>12</sup> Nor was this step straightforward. It was pointed out that Britain was debarred by the

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7. T 160 590 8797/05/1.

8. T 160 590 8797/05/2, Telegram to Treasury, 18 May 1934.

9. T 160 590 8797/05/1.

10. T 160 590 8797/05/3, minute SDW to FLR, and note by FLR.

11. BE OV34/198, 13 June 1934.

12. T 160 590 8797/05/3, letter to Runciman, 4 June 1934.



Anglo-German Treaty of 1924 from imposing any special duty or levy on German goods. Reparations could only be collected by the reimposition of the Recovery Act of 1921, and this, of course, would have involved abrogating Lausanne and contradicting the diplomatic notes recently sent to America.

On 14 June the Reichsbank made the expected announcement. A moratorium, to take effect from 1 July, was declared on the transfer of interest by foreign exchange on all Germany's debts. Foreign creditors were offered ten year funding bonds bearing interest at 3 per cent. In 1932, thanks to foreign credits, Germany's foreign exchange reserves stood at well over Rm1 billion. Just two years later these amounted to a mere Rm200 million.<sup>13</sup> Indeed, the first six months of 1934 witnessed such a rapid deterioration in Devisen reserves that they did not exceed 2.5 per cent of note circulation. This point of virtual exhaustion (which became the norm from now on) had been reached because imports, not only of raw materials, but also of manufactured articles, had increased while exports had declined. And, although British experts could only speculate at the time, it seems that the shrinkage in gold and foreign exchange reserves was made more spectacular by the Reichsbank itself, which had hurriedly repaid certain loans.<sup>14</sup>

Although Schacht offered a lengthy apology for this step, every country which was in a position to do so started negotiations for more favourable treatment. The day after the Reichsbank's announcement, the Chancellor announced to the House of Commons that he proposed to seek powers to set up an Anglo-German Clearing Office, and the British Ambassador in Berlin simultaneously informed the German Government of the same.

This evoked an immediate response from the German authorities. On 15 June von Hoesch handed a note of protest to Secretary Simon. It was maintained that the British Government had overlooked the fact that the Empire as a whole enjoyed a favourable trade balance with Germany. In the event of a clearing, corresponding reprisals against English and Empire imports into Germany were threatened. Nevertheless, the British Government was not to be deflected from its course and the Treasury reply to the German note was considered by Chamberlain to be, "a most damaging exposure of a fraudulent debtor." The Cabinet agreed that a clearing would stand as a measure of defence in regard to discrimination against Britain which no other defaulting country had attempted.<sup>15</sup>

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13. Guillebaud, Economic Recovery, p.64; G. Stolper, The German Economy. 1870 to the Present (New York, 1967), p.114.

14. Ellis, Exchange Control, p.200.

15. T 160 590 8797/05/3; CAB 24/249, 169, Memo. by Chamberlain and Runciman, 18 June 1934.

But there were powerful counsels in London which advised against the imposition of a clearing if it could be avoided. The Treasury was left in no doubt about Governor Norman's opposition to the idea. He was viewed as a conciliatory force, and as such was successful in passing on his worries to high officials. Sir Richard Hopkins minuted that while preparations for a clearing were unavoidable, it was not known what Hitler would do in turn about the Standstill, or whether the City would continue to hold Standstill bills. Moreover, he feared that having to pass an Act putting these bills into cold storage and guaranteeing the Governor against loss upon them would be most unsatisfactory.<sup>16</sup>

Montagu Norman was strongly supported by the London Joint-Stock Banks. He acted as intermediary between the Chancellor of the Exchequer and the Joint Committee. Beaumont Pease, chairman of the Committee, wrote to the Governor about the apprehension which was felt lest the imposition of a clearing should bring about a situation in which the continued operation of the Standstill might no longer be possible. The bankers believed that the maintenance for German commerce and industry of the credit facilities covered by the Standstill was of the first importance for English bondholders and merchants, as well as for all others concerned with Germany's economic stability.

If a clearing were established, wrote Beaumont Pease, bankers who had hitherto looked to the authorities in Germany to provide the foreign exchange necessary to meet the current obligations of German debtors, might be compelled thenceforth to look to the clearing for support. The letter claimed that an embarrassing situation would arise if, for any reason, the surplus established by a clearing ceased to exist.

Seemingly bankers never tired of pointing out that the Standstill was entered into at the express request of governments represented at the Seven Power Conference of July 1931. The intention was to stop the continued withdrawal from Germany of banking facilities of all kinds, and thus avert a general financial breakdown. They were proud that this had proved effective in preserving for Germany credit facilities essential to her trade. They felt their actions had been not only in their own interests, but also those of the medium and long-term creditors, and in accordance with the policy of the British Government.<sup>17</sup>

Beaumont Pease's letter enclosed a lengthy memorandum by the Joint Committee. The memorandum concentrates on the role of English bank credits in Germany's foreign trade, and thereby creates the impression that bankers hoped to deter government from interfering in an area of business which was always technical and sometimes highly complex.

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16. T 160 590 8797/05/3, 12 June 1934.

Banking credits to Germany were of several kinds; although all had a bearing on Anglo-German trade, only a small part of them were used to finance direct trade between the two countries. German exports to Britain, when not paid for in cash or trade acceptances, were sometimes financed by acceptance credits granted by English banks.

It may help to interpose at this point a full explanation of acceptance credits (short-term loans), which is contained in a Board of Trade memorandum. For German goods imported into the U.K. the normal procedure was as follows. Before the Standstill a German exporter was granted a credit by a London bank through his German bank. The exporter sold to the U.K. importer and drew on the London bank where the credit was established for ninety days. This bill was forwarded by the exporter through his bank for acceptance, and having been accepted by the drawee (U.K. importer) was discounted by a London House, the proceeds being made available to the German exporter and sold by him to the Reichsbank against payment in marks.

On the due date the U.K. importer remitted the price of the goods to the German exporter, who sold this sterling payment to the Reichsbank. The holder of the acceptance presented it to the acceptor (that is, the London bank which had granted the credit) by whom it was paid, the bank being put into funds by the German exporter who either obtained sterling from the Reichsbank, or alternatively renewed the bill. That is to say, the exporter drew another bill in respect of further goods, and discounted it using the proceeds to reimburse the London bank giving the credit in respect of payment of the first bill.

For U.K. goods imported into Germany, the importer was also granted a short-term credit by a London bank. On selling the goods the U.K. exporter drew on the bank where the credit was established. This bill, having been presented to, and accepted by, the drawee (German importer) was discounted by

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17.T160 534 13460/08, 21 June 1934.

See MB 30/189 for draft letter which intimated that bankers and merchants would look to the Government for help in the event of any difficulties. See also BE OV6/290 for memo. by Stopford, 12 June 1934. He felt that a clearing would lead to a breakdown of all arrangements for dealing with German debts internationally with consequent competitive grabbing by the various creditor countries. Germany would then be deprived of the purchasing power for essential imports and she would be reduced to a state of economic chaos. Collapse of the Standstill would quickly bring this about.

the U.K. exporter using a London House and the proceeds made available to the exporter. On the due date the acceptance was presented to, and paid by, the acceptor (the London bank which granted the credit). The bank was duly put in funds by the German importer, who for this purpose had to obtain the necessary permission from the Reichsbank to remit sterling.<sup>18</sup>

The Joint Committee's memorandum reveals how the English banking system also provided a large volume of credit for the financing of international transactions in which Germany was concerned; particularly trade with British colonies and Dominions, involving raw materials into, and manufacture out of, Germany. The total volume of credit was very much greater than that for direct Anglo-German trade. Bankers were keen to point out that such international credits were in continual use, and their maintenance for the previous three years had been a vital factor in the maintenance of Germany's export surplus, and consequently her ability to pay her long and medium-term debt service. Germany, therefore, had to maintain adequate facilities for buying in the world market.

Again, the Board of Trade explained how this worked in practice by taking the example of the financial arrangements involved in the import of wool into Germany. The value of this trade in 1933 amounted to £22.5 million for U.K. exports, and £138.4 million for Empire exports. In similar fashion, the German importer arranged with his German bank a credit with a London bank. Wool was bought by an agent in Australia for spot cash. The latter then drew a documentary bill for the price of the wool on the London bank where the credit had been established, and discounted the bill with an Australian bank. After the wool had been shipped (usually in German vessels), the bill was accepted by the London bank in exchange for the documents. These were sent to the bank's agent at the port of discharge, or the German bank, or the German importer. In the case of a confirmed credit, the London bank, having paid the acceptance at maturity, debited the acceptance credit and in due course was reimbursed by the German bank; otherwise the German importer undertook to put the London bank in funds before the date of maturity.<sup>19</sup>

The banker's memorandum also emphasised how English banks provided a large volume of finance for German banks and industrial or commercial concerns. Many of the credits were originally used for the movement of goods, but with the contraction of trade they came to represent general finance for the German business.

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18.T160 534 13460/04.

But the real purpose of this analysis of the complex inter-relationship between the banks and Anglo-German trade, was to argue that any clearing would upset the balance of limitations and obligations on both sides, or compromise reached. The Committee did not believe that, with the high volume of daily transactions, credits could be excluded from a clearing. A further objection was that sterling payments to the Reichsbank might be delayed, thereby interrupting the flow of foreign exchange necessary to procure continuance of the credits. The bankers feared a situation in which the Standstill broke down with the international creditors fighting each other. If, in these circumstances, no alternative arrangements were made for English credit, the £34 million worth of bills which were payable within three months and mostly discounted on the London market, would not have been renewed at maturity. This would then have placed an enormous strain on the acceptance houses.

The conclusion of this document was that clearing schemes were in their nature destructive of anything except bilateral trade; they were particularly destructive of Germany's trade which, like that of most industrialised countries, involved her buying in markets different from those in which she sold. Clearings were also damaging, it was claimed, to all Germany's creditors. The fear was that a hostile relationship between the two countries would then arise over the question of debts, which would give extreme elements in Germany grounds for advocating default.<sup>20</sup>

The bankers appeared to forget that the whole question of a clearing had arisen because this last fear had been substantially realised. Nor was the Treasury convinced by these arguments. It was thought that the Bank of England could show that such a small amount of trade was financed by these credits that the problem was not of any appreciable dimension. Moreover, under the clearing proposed, U.K. exports to Germany were not included, while German exports to the U.K. were. It was hoped that through such a limited clearing 80 per cent of the sterling derived from U.K. purchases of German goods would remain at the disposal of the Reichsbank, and that exchange would therefore be available to cover bills at maturity. It was also noted that the Standstill represented £34 million of British capital, as against £60 million in long and medium-term loans.<sup>21</sup> According to Nigel Law the fact that City protestations against the idea of a clearing had not

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19. *ibid.* For a contemporary reference work see R.J. Truhtil, British Banks and the London Money Market (1936).

20. T 160 534 13460/08; for draft, see MB 30/189, 19 June 1934.

21. T 160 534 13460/08, minutes by SDW and FLR, 23 June 1934.



swayed the Treasury had led some to believe that there was a powerful anti-City influence in that department. But Law pointed out that the Government could not afford to be accused of favouritism towards "High Finance".<sup>22</sup>

Neville Chamberlain wrote to the Governor in an attempt to pacify the banking community. The Chancellor indicated that Britain had not taken the lead in the matter of clearing schemes. France, Switzerland and Holland had already obtained powers from their legislatures. The Government, in view of the refusal by the German authorities to accept the very favourable proposals put forward, felt it had no option but to obtain similar powers. Chamberlain agreed that any clearing should be as limited in scope as possible, and that the maintenance of the Standstill was desirable for both Germany and Britain. However, he pointed out that the Standstill and the German Public Debtors Agreement had been excluded from the negotiations, that only a small part of German imports were financed by the Standstill, and that the proposal was to collect only 20 per cent of debts due. Chamberlain told Norman that the Government did not therefore envisage any problems developing.<sup>23</sup> Privately, Chamberlain was less self-assured. A clearing, he feared, would disturb trade to some extent, but he did not know what else to do. He wrote, "The Germans are trying to swindle their creditors and we cannot be the only ones to abstain from retaliation".<sup>24</sup>

Hopkins, however, had the support of his superiors when he reluctantly agreed with the Governor that, "an agreement extracted from the Germans would be a political triumph of a far higher order than the imposition of a clearing, and also far better for British industry."<sup>25</sup> Yet the extent of the "political triumph" would obviously depend firstly upon the terms of the agreement and secondly upon how smoothly any agreement worked in practice.

Moreover, certain sections of British industry were most intent on receiving payment for their exports to Germany, something which was becoming increasingly difficult. The London Chamber of Commerce informed the Chancellor that some of its members had already stopped shipments because of the intensified problem of receiving payment.

One trade of great importance to Germany was the import of oil seeds, oils and fats. The biggest supplier was a British company which protested that there had to be a change of attitude by the German Government. As the German importers could not obtain confirmed bankers' reimbursements there was no security for fulfilment of contracts and further business was at a standstill. Fewer exports to Germany might mean increased prospects of sterling payment for other exporters, but, of course, the export trade of the country as a whole would suffer. The London Chamber of Commerce therefore considered it

inequitable that the British Government should undertake to collect, first and foremost, the debts of the bondholders from any clearing.<sup>26</sup> The National Union of Manufacturers supported this view. They appreciated the need to devise defensive measures at short notice, but they felt it would be both inequitable and injurious if the operation of a clearing Act should place a heavy burden on the trade of the U.K., just for the purpose of relieving certain bondholders.<sup>27</sup>

In response to the voluminous correspondence from the commercial community the Department of Overseas Trade felt compelled to point out to other departments that the proposed limited clearing, for the purpose of settling only bondholders' claims, fell far short of what traders were anticipating. There was concern that a partial clearing would increase rather than solve the problems of the U.K. export trade, since the Germans would have even less sterling at their disposal for the purchase of British goods. It was therefore put forward for consideration that the negotiations under way should not be confined solely to the issue of the Dawes and Young Loans, but that complete assurances should be given that both the current trade and outstanding debts of U.K. exporters would be liquidated from the proceeds of German exports.

The Treasury did not want to appear to be influenced by these arguments, any more than by those of the bankers. Britain would simply get what it could in way of settlement of old trade debts, although there was to be no commitment on how successful negotiations would be on this point. Rather it was hoped that British traders would quietly sell their blocked marks at a discount, just as they had been willing, in many cases, to make a sacrifice to get out of other countries in which they had been stuck.<sup>28</sup> Thus the Treasury appeared to be willing to allow, in effect, a tax to be imposed, for the benefit of Germany, on exporters in a period of trade depression.

Nevertheless, Waley, at least, recognized that trade debts would have to be given priority immediately after the Dawes and Young Loans. Certain trades with Germany, such as the herring exporters, were in a particularly dire condition. Trade debts had piled up owing to successive reductions in exchange

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22.F0 17682 C3805, letter to Sargent, 15 June 1934.

23.T 160 534 13460/08, 28 June 1934.

24.NC 18/1/876, letter to Ida, 22 June 1934.

**25.**T 160 590 8797/05/4, Memo. 27 June 1934.

26. T 160 534 13460/04, Frank Fehr & Co., and London Chamber to Chancellor, 11 July and 27 June 1934 respectively.

27. T 160 534 13460/06.



quotas allowed to German importers . Towards the end of June German authorities decided to ignore all previous exchange permits and to ration out exchange in accordance with the amount available on any one day.<sup>29</sup>

ii) Anglo-German Transfer Agreement and the Exchange Agreement for Commercial Payments.

The Government had certainly added a new technique to the art of British commercial diplomacy when Parliament hurriedly passed the Debts Clearing Offices and Imports Restrictions Bill. It provided for a 20 per cent ad valorem duty on imports.<sup>30</sup> The Act received the Royal Assent on 28 June; it was decided to publish the Order in the newspapers of 2 July, and to start the operation on 5 July if agreement with the German delegation had not been reached in the meanwhile.

It would be reasonable to suppose that with the benefit of the pressure under which the German negotiators must have been placed by this legislation, an agreement on terms favourable to Britain might have been secured. On 4 July the negotiations were indeed concluded by the signing of the Anglo-German Transfer Agreement. Britain agreed not to exercise the powers created by the Act. In return, the Reich Government confirmed the provisions of the Berlin Transfer Conference of 29 May 1934.

In other words, the German authorities promised to end discrimination between creditors and to provide sterling for the purchase of Dawes and Young coupons. Interest on loans other than these two was to be paid in 3 per cent funding bonds - subject to the proviso that bondholders were entitled to put forward a claim if there was discrimination. However, amazingly, no direct provision at all was made for the liquidation of debts due to British traders.<sup>31</sup> Instead, a letter by one of the German negotiators, Dr. Berger, stated that his government agreed to enter, without delay, into negotiations for the conclusion of an exchange agreement for commercial payments.

This agreement was subjected to careful analysis by Paul Einzig, the financial journalist. In an article entitled "The German Agreement:- Robbing Peter to pay Paul?", he claimed that the City received the terms of the agreement

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28. *ibid.*

29. *ibid.* SDW to St. Quinton Hill (Board of Trade).

30. E.V. Francis, Britain's Economic Strategy (1939), p.272.

31. Cmd.4640.

with mixed feelings. Those concerned with the Dawes and Young Loans were naturally delighted; bankers in general were pleased that the application of the Debts Clearing Offices Act had been suspended for six months, though they were somewhat worried by the possibility of an exchange agreement for a voluntary clearing of commercial transactions.

But exporters, in the opinion of Einzig, were at the mercy of Dr. Schacht. They feared that the agreement had been concluded at their expense. The article also claimed that the extent to which German imports had been financed by new commercial credits outside the Standstill was not generally realised. While most banks had been unwilling to grant new credits to Germany, exporters all over the world had continued to ship goods on a credit basis. Because of the long standing connections between British exporters and German importers, the former had been willing to deliver goods against book credits, or bills drawn upon them and accepted by the importers. According to Einzig, it was thanks to this confidence that Germany had been able to import on such a large scale in 1934. The article was simply dismissed by the Treasury as a reflection of the views of some of the less reasonable members of the London Chamber of Commerce.<sup>32</sup>

The Foreign Office was keen to learn a lesson from the German negotiations. Nigel Law claimed that the firmness of the Government's action was widely praised and that quite a number of bankers were ready to admit to the value of the method of negotiation which first placed "the British boot firmly on the Teutonic face". There was, however, no exaggerated optimism: the City was relieved that there was to be no economic warfare for the time being, but the recent events had undermined Germany's credit far more effectively than any default.

Sargent also thought that Schacht's policy had been calamitous for Germany. But he had heard that Schacht justified himself by going round saying that, at any rate, he had the support and approval of Montagu Norman in all that he had done. Wigram wrote of the need to guard against the errors of 1920-1933: the belief that Germany could be conciliated by a policy of unilateral concessions. Not so much was now made of the theory that it was inadequate concessions by the former allies which had produced the Hitler régime and its rash experiments in foreign policy. Quite as probably, Wigram thought, it was the weakness of the allies which had tempted the Germans to overplay their hand. For Vansittart the agreement vindicated all that he had said: "the German climb down on the main point is a triumph for the Foreign Office not only over the Germans but over the other departments of His Majesty's

Government, who were distinctly reluctant to talk the only language which Germans understand".<sup>33</sup>

Some weeks earlier the Foreign Office had passed on to Leith-Ross an anonymous letter which reported a conversation with Montagu Norman, at the Bank of England, on 9 June. Norman apparently revealed that while he was indifferent to the fate of the long-term creditors, he would back Schacht in every way possible to keep Germany's short-term position satisfactory. The Governor, according to the letter, admired Schacht as a great banker and as a great man. He had also been convinced by Schacht that the alternative to the Nazi régime was Bolshevism. Furthermore, Norman was obsessed with the idea that the moderate parties in all countries (and with them democracy), were doomed.

Leith-Ross offered his opinion to the Foreign Office that Norman's "incomprehensible admiration" for Schacht did not affect his desire to protect Britain's financial interests. Leith-Ross wished to place on record that, as much as Norman disliked and feared a clearing, he and his officials had given loyal and valuable assistance in its preparation.<sup>34</sup> Chamberlain had also shown a resolution in the German negotiations which he seemed to lose later in the decade. He doubted whether the Germans would sign the agreement, "for they bluff so persistently and as a rule so successfully that it was hard for them to believe that we really meant business. But finally we gave them an ultimatum and they collapsed. Everyone was very pleased and undoubtedly the Government stock went up further."<sup>35</sup>

The idea of an Anglo-German exchange agreement was first proposed in 1933 and met with differing responses from Britain's financial community. Bankers were immediately suspicious of any arrangement which remotely resembled a clearing, or which caused Central Banks to interfere with the business of merchant banks. In his capacity as a director of the Bank of England, Charles Hambro produced for the Treasury a list of the usual arguments against the proposal, and reasons why the Bank would decline to act as agent. These included the belief that such an agreement would involve the 'canalization' of trade, and depletion of the Reichsbank's reserves. It was also held that exchange agreements were not designed for trade as diversified and changing as Britain's which was carried on largely on credit and had, therefore, to be as free as possible from bureaucratic control. Finally, Hambro declared, it would lead to exchange dumping vis-à-vis Britain to the disadvantage of industries producing for the home market.<sup>36</sup>

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32. T 160 522 12750/02/3; Financial News, 6 July 1934.

33. FO 17684, C4611/C4613/C4699.

34. T 188 77, FLR to FO, 11 July 1934.

The case for an agreement was put by the Embassy in Berlin. Thelwall saw how the lack of an agreement might be detrimental to British exports, as all other important European trading nations had such arrangements with Germany. He also believed that the bankers were arguing only from their own self-interested point of view, and that having secured certain advantages for themselves, they should have let commercial men have their turn.<sup>37</sup>

Indeed, Thelwall grew impatient with Hambro's opinions, considering it curious that the banker could not grasp the reason why different kinds of marks commanded different prices according to the disabilities which attached to the various categories. The marks resulting from an exchange agreement, the counsellor pointed out, were commercially free and might even be used for certain non-commercial payments. They therefore commanded higher prices than blocked marks, the use of which was limited. Thelwall rounded off his explanation by concluding that if Hambro's arguments were taken to their logical end, it would have been just as reasonable to say that British bonds and Turkish bonds should command the same price because they were both bonds.<sup>38</sup>

But the Bank of England continued to oppose the proposed scheme. This is evident from correspondence in October 1933 between Sir Walter Preston, M.P., and the Governor, with the former attempting to convince the latter that an exchange agreement would not so fetter trade that on the whole it would lead to a shrinkage of England's business with Germany. The point was made that no objection had been raised to all of Russia's trade coming to Britain through the agency of the All Russia Co-operative Society (ARCOS); traders submitted to this condition as they wanted Russia's business. But again, the Governor voiced his concern that British exporters should assume commitments without being aware of the uncertainties and risks of Konversionskasse marks.<sup>39</sup>

However, the officials in the Berlin Embassy were not to be deterred. They did not see any reason why marks would have to be discounted or why the Bank would be stuck with them. What they did see were exchange agreements between Germany and other countries working well and tending to divert trade away from Britain to these countries. A number of British exporters were even sending goods, to their German clients who had exhausted their exchange quotas, through Holland which had an exchange agreement with Germany. At a time when

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35. NC 18/1/878, letter to Ida, 7 July 1934.

36. T 160 521 12750/02/1, 13 March 1933.

37. *ibid.* Thelwall to Rowe-Dutton, 3 March 1933.

38. *ibid.* 8 Aug. 1933.

39. T 160 521 12750/02/2; Preston was chairman of Textile Machinery Makers Ltd. For the origin of the Konversionskasse see Chapter IV.

the Government were making the greatest effort generally to expand exports, the Embassy considered that such an agreement would be practically a gratuitous means of maintaining the country's position against those countries which were damaging Britain on the German market.

In a memorandum considered too strident for circulation Thelwall criticised Norman for resisting the idea of an exchange agreement which, he claimed, the Governor confused with a clearing system. But one suggestion by Thelwall was taken up: the Chancellor and President of the Board of Trade would have to persuade the Governor. Cobbold, a leading Bank of England official, noted that the Bank's arguments against an agreement had always been rather thin and that they could not stand out against it any longer. He considered that the agreement would undoubtedly be a nuisance to them but would aid some exporters. Cobbold's preference was to get the Treasury to write a brief official letter to the Bank, merely asking whether the Bank was prepared to undertake the practical execution of the Agreement. This was approved. So, faced with the unanimous decision of the departments of government in favour of introducing an exchange agreement, the Bank declared that, "in these circumstances we should naturally not wish to stand in the way".<sup>40</sup>

The proposed scheme then lay dormant while the more pressing affairs of the bondholders received attention. But in March 1934 a draft agreement was sent over to Berlin. Yet, no instructions to make definite proposals were given until April, by which time Germany had decided to replace its existing agreements. While Parliament was passing the clearing legislation, reports of the hardships and difficulties facing British traders began to mount. Even though U.K. firms had taken every precaution to assure themselves that their German customers were in possession of foreign currency sufficient to cover the order placed, it was impossible to provide against a rapid reduction in the basic quota, from 50 per cent in February to 10 per cent in June. British firms found their customers unable to pay, except for current imports necessary to keep business going, and consequently experienced serious losses because of the system of blocked accounts. Although U.K. businesses did not buy and sell to the same German firm, they clamoured to be allowed to offset their credits in Germany against their debts, especially as their European competitors enjoyed such an advantage.<sup>41</sup>

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40. *ibid.* Memo. by Thelwall, 21 Nov. 1933; Thelwall to SDW, 15 Dec. 1933; Cobbold to SDW, 18 Dec. 1933. BE OV34/195, Cobbold to Deputy Governor, 18 Dec. 1933.

41. T 160 522 12750/02/3.

The FBI wrote to the Treasury suggesting that there had to be a definite limit on the amount of blocked marks which could be used to assist 'additional' German exports, or that a definite proportion of the exchange accruing on account of German exports should be reserved to commercial debts and current trade. The FBI complained that its members felt that the reduction in the sums due to them had arisen because they had been made to take second place to other creditors, in the division of the exchange made available as a result of British purchases of German goods.<sup>42</sup>

Following the July Transfer Agreement, negotiations, taking place in Berlin, became intense. But Pinsent could only gain assurances from his opposite numbers that they would do their best to clear frozen trade debts. Surprisingly this did not seem to cause too much concern at the Board of Trade; Sir Henry Fountain declared that the agreement did not touch the vexed question of frozen debts, which was seriously disturbing many British traders, particularly the coal exporters and Lancs cotton spinners. This was justified, he felt, because the German authorities would never have agreed, nor would it have been wise, to attempt to burden the special account proposed under the agreement with the additional marks involved in the liquidation of the frozen debts.<sup>43</sup>

On the 10 August 1934 the Exchange Agreement for Commercial Payments was signed in Berlin. When a German importer of British goods used up his foreign exchange quota (which presumably took next to no time), he would now pay the balance into a special account (Sondermark), opened at the Reichsbank in the name of the Bank of England. The Reichsbank could suspend payments into the special account when the total unsold amount exceeded 5 million marks. The Bank of England could make payments out of the account for goods exported from Germany, or other payments. The agreement was not intended to lead to the alteration in the balance of Anglo-German trade. It also seemed experimental in nature; only two weeks' notice of termination by either side was necessary.<sup>44</sup>

Moreover, the scheme was voluntary. It depended for its success on the extent to which British importers of German goods, used the account in paying for their purchases. It was expected that as Britain imported more than she exported, demand for Sondermarks would be adequate for the working of the scheme, and that new British exports could be financed without straining German

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42. T 160 522 12750/02/5.

43 T 160 522 12750/02/6, Draft Memo. 6 Aug. 1934, to Pres. of Board of Trade.

44.Cmd.4673.



foreign exchange. But Cobbold asked his colleagues not to be led by Einzig into thinking that the Government believed that it had made a satisfactory agreement. For it was no solution of the transfer problem. Cobbold believed that the Germans hated such agreements and that they would call Britain's bluff and themselves impose a clearing on the Empire.<sup>45</sup>

Indeed, it quickly became apparent that the agreement was not operating efficiently. The demand for Sondermarks was less than the supply. It emerged at a meeting of the London Chamber of Commerce that many importers would continue to buy for sterling (thus avoiding speculation in exchange), even if a forward market for Sondermarks existed, because they feared that German exporters would refuse to carry out their contracts if the mark depreciated.

It seemed, therefore, that some of the Bank of England's fears were realised, if for the wrong reasons; namely, traders were only too aware of the risks attached to currency transactions. German creditors too preferred payment in sterling which was, of course, freely convertible. Meanwhile, the Governor himself expressed his general abhorrence of the agreement. He was totally against the idea that importers used to buying in sterling should have to change to Sondermarks.<sup>46</sup> When, exactly one month after the signing of the agreement, the total unsold balance reached Rm7 million (£600,000), the acceptance of further Sondermarks in payment for goods exported from the U.K. to Germany was suspended, and an interim account was set up in which the total grew to more than three times this figure.<sup>47</sup>

The British Government was now faced with a growing problem. Civil servants realised that as the Government was responsible for the agreement it would be held responsible for the Sondermark debts. But the frozen debt claimants were, if anything, the more vocal of the two. A case began to be made for extending favourable consideration to the Sondermark claimants, because their debts had been incurred wholly as a result of U.K. exports, while one half of the frozen debts had been incurred in respect of re-exports or foreign goods sold through London.

Such discrimination between creditors of Germany seemed, however, to make little sense. Although the Government had been reluctant to protect the interests of British traders with Germany, it had eventually concluded an exchange

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45. BE OV34/197, Memo.16 Aug.1934.

46. T 160 558 12750/02/01/1, Minutes by Phillips and SDW, 7 Sept.1934 and 3 Oct. 1934, respectively.

47. T 160 535 13460/010/2.



agreement. When this quickly showed itself to be unsatisfactory, politicians and officials were faced, for the second time in a few months, with the possibility that they would have no alternative but to impose a clearing, if negotiations for a workable arrangement proved unfruitful.

The problems of the coal exporters and Lancs cotton spinners had become particularly acute. With mounting commercial debts owed by German importers of cotton yarn, the industry had taken the decision in August to stop further deliveries, even though they feared they would lose their market to Swiss and Czech goods. Responding to appeals from the German importers, the Lancs exporters entered into negotiations in Berlin to obtain their money through separate arrangements. Finally the Board of Trade showed concern. As Fountain wrote, "Clearly it is Schacht who will be the real negotiator and he may have formed the intention of dividing U.K. interests, satisfying those whose exports are necessary to Germany, and leaving others to complain".<sup>48</sup>

By the first week of September, therefore, officials began to monitor the pressure to set up a clearing in order to liquidate frozen trade debts, facilitate current trade in so far as the Exchange Agreement failed to provide for this, and to serve the interests of British bondholders. Sir Frederick Leith-Ross compiled a list of grievances against Germany. The 1924 treaty had precluded licensing, quotas or discrimination, but exchange control had enabled all these guarantees to be evaded. Britain had given Germany a number of tariff concessions in 1933 against increased exports of coal - up to 200,000 tons extra - but exporters were not getting paid. Of course, other trade debts were still not settled. The Lancs exporters, whose debts amounted to £400,000, seemed on the point of accepting an unfavourable offer. Finally, the question of discrimination against British holders of non-Reich loans had emerged yet again. Since the Transfer Agreement Germany had concluded agreements giving Swiss and Dutch holders better terms than the British. The former were to receive interest up to 4.5 per cent on non-Reich loans (the balance of the normal interest being used as a sinking fund), whereas the British were to receive funding bonds which would only be worth 25 per of their nominal value. Sir Frederick concluded that, "The whole position is so chaotic that it is difficult to see the lines on which trade can be maintained."<sup>49</sup>

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48. T 160 534 13460/010/1 , Fountain to Runciman, 23 Aug. 1934.

49. *ibid.*

In the Bank of England two Advisers to the Governors clashed over the best policy to pursue. Siepmann questioned whether the initiative lay with Britain. The German threat of a compulsory Empire clearing could create endless trouble for Britain with the Dominions. It had always been considered that the raw materials which the Dominions supplied were indispensable. Yet Siepmann thought that Germany could divert her purchases. So, in his opinion, commercial arrears would have to be overtaken by new trade; for the sake of their credit debtors would be keen to pay somehow. The middle and long-term bondholders would have to be abandoned to their fate: Britain had already done remarkably well. Indeed, the doctrine of equal treatment as between nationalities could no longer be sustained in practice. On tariffs, on competitive currency depreciation, and on disarmament Britain had allowed herself to be forced to do harmful things of which she disapproved. Thus Siepmann had no doubt that by being "sensible" with Germany Britain had everything to gain, as she would have by renouncing the policy which substituted 'authorities' in Britain for the original claimants on Germany. Rather, it would be better to leave Schacht to clear his sterling receipts in the agreed order, within the German foreign exchange system.

But Clay thought that this would virtually relinquish the control of policy to Schacht who was already attempting the impossible. The governing factor in the problem of Anglo-German relations would continue to be Germany's deteriorating trade position. Clay predicted that the problem of the priority of different British claims would be brought up every two or three months and that each piecemeal settlement would excite fresh ill-feeling and create new problems. The British Government needed, therefore, some machinery for balancing conflicting British claims and agreeing with the German authorities the order in which they should be met.<sup>50</sup>

To compound the problems Schacht announced on 19 September even more stringent arrangements for the control of Devisen allocation, which came to be known as his 'New Plan'. It was freely admitted in Germany at this time that, with the enormous Devisen deficit, the whole quota system of allocating foreign exchange had failed abysmally. News arrived from Berlin that the authorities had decided to abolish, from late September, all the general exchange permits, and to subject all imports to licensing. The few remaining openings for British exporters seemed to be closing rapidly. Leith-Ross, "desperately gloomy" about the whole situation, recommended that Berlin's offer of new negotiations had to be taken up, in order to forestall complete control of trade by Germany.<sup>51</sup>

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50. BE OV34/200, Memo. by Siepmann, 4 Sept. 1934 and by Clay, 10 & 14 Sept. 1934.

51. T 160 559 12750/020/1, Memo. FLR to Chancellor, 13 Sept. 1934.

Vansittart wrote to Leith-Ross to put his point of view (which was very similar to that expressed by Clay), that in new negotiations with Germany, any agreement should cover the whole field of economic and financial relations, instead of dealing with each issue separately. Vansittart felt that any other procedure would give the German Government an undue and dangerous advantage.<sup>52</sup>

iii) The Renewed Threat of a Clearing.

Anglo-German relations had indeed reached a nadir. Those responsible in Britain for executing policy were despondent and frustrated. Treasury records include a memorandum entitled "The Debts Impasse", which, although unsigned and undated, bears all the hallmarks of Leith-Ross's hand. Its value lies in the extent to which it reveals a sense of disillusionment.

The document concentrates on questioning Schacht's argument that a complete moratorium for six months had been required from 1 July. Foreign creditors had been prepared to go a long way towards this position. But they held that, in so far as they were sacrificing a part of their claims, they were providing funds for the stimulation of German imports, and that the resulting Devisen had to be used for their benefit. There was no doubt about the lack of propriety of capital repayments under the Standstill. It was dishonest, the memorandum continued, for a debtor to plead he has no money to pay the interest on his debt and then, nevertheless, to repurchase the capital of his debt which has been depreciated by his failure to pay interest. British creditors were not altogether opposed to this which, owing to the higher price which such bonds commanded in Germany than elsewhere, offered a means of subsidising German exports without depreciating the mark. But they did insist that a minimum per-centage of interest should be transferred in cash before any of the capital was repurchased.

Schacht was roundly condemned. He alleged that Germany's foreign loans were political merely because the country had borrowed money (to build swimming baths and blast furnaces) at the same time as she was paying Reparations. Schacht spoke as if the only obstacles to international trade were devised by foreign countries, but Germany was early in the protectionist field, "her recent agricultural policy is the most extreme example of economic nationalism in the world." Yet, he was furious when the creditors were unanimous in suggesting that Germany's expansionist policy, with the consequent rising demand for raw materials, and her political policy, resulting in foreign boycotts of German goods, were partly responsible for the transfer difficulties. He was also blind

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52. T 188 93, 13 Sept. 1934.

to the fact that Germany had to retain good relations and preserve her credit if the German population was not to be reduced to a low standard of living inside an autarkic ring fence.

In a bitter summary the document pointed out that ever since the war (1914-18), the U.K. had taken the lead in trying to help Germany to re-establish her position, both politically and financially. The City had put funds at Germany's disposal and kept them there when other countries had withdrawn their credits;

"Our efforts, however, have been completely nullified by the policy followed by Germany herself. Schacht may not be responsible for the economic policies of the Hitler régime: but he is largely responsible for the policy of financial fraud which is now being practised. Like continental countries we will now have to consider a clearing - it seems the only way to teach the Germany of today and Dr. Schacht in particular that honesty is the best policy."

The effect of a clearing on Germany, it was believed, would be to curtail seriously resources for imports and raw materials, and to accentuate unemployment and discontent - a prospect thought to be so disastrous that it was hoped that the Nazis would recoil from it at the last moment.<sup>53</sup>

These opinions were echoed by the FBI. This organisation had come to view Schacht as a clever amoral patriot, who subordinated international trade to the primary object of stimulating German domestic production and employment. Germany had managed during the past decade to obtain imports without paying for them; firstly by long-term loans on which she defaulted, secondly via short-term Standstill credits which were still unpaid, and lastly by failing to carry out promises to exporters. It appeared to the FBI that Germany was carrying the process a stage further with the Sondermark account, by obtaining goods on credit while not assisting in the liquidation of the account. The Nazis were, therefore, going to make it as difficult as possible for past financial obligations to be honoured.

The FBI complained that if British exporters endeavoured to demand cash against documents, business would be diverted to those countries able to offer more favourable credit terms. There was already a fairly extensive use of various forms of compensation arrangements and private clearings. Exporting to Germany was likened to the experience of trading with Russia, in so far as manufacturers felt compelled to offer extended credit terms, provided they received some assurance that they would be paid in full in a reasonable period.<sup>54</sup>

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53. T 160 714 8797/07/1.

54. T 160 534 13460/010/2, General economic & intelligence division, FBI, to SDW, 4 Oct. 1934.

It was not surprising, therefore, that Leith-Ross sought to present the strongest possible face in preliminary discussions with German ministers. Whatever British exporters might do in practice, he tried to convince von Neurath that Schacht was mistaken in thinking that the German market was so strong that other countries would be forced to give Germany goods on credit rather than not export at all. In any competition in suicide, Leith-Ross proclaimed, Britain would last longer than Germany. He warned that Britain would cut off trade if Germany reduced British exports. The case of cotton yarns was cited, whereby Germany bought from Switzerland through their clearing agreement, rather than from Britain where prices were 20 per cent lower.

Schacht, however, claimed that he had no desire to divert purchases of raw materials from normal channels. He wanted to maintain the London bills and facilities for international trade; London was the best centre through which to organize buying. But when Schacht attempted to draw an analogy between British war debts to America and German debts (incurred, in his view, in order to pay Reparations), Leith-Ross refuted the idea that the Dawes and Young Loans were anything other than purely commercial loans.<sup>55</sup>

But to those concerned in London, Leith-Ross's advice on the situation in Germany and policy to be followed, differed substantially from the foregoing. It would, he wrote, be a mistake to expect any sudden change in the Nazi régime. Although the economic situation was approaching a crisis, Germany could last out a long time on her own resources - she could not be blockaded into submission, "We should, therefore, do all we can to maintain our trade with Germany so long as we can do so without increasing our credit commitments to her". Instead, it was hoped that the inconsistency between financial and economic policies would lead to an impasse, almost certainly forcing Germany to devalue.<sup>56</sup>

Chamberlain was frustrated that he could not exploit this situation in order to direct foreign policy. He wrote that he should be trying to bring about an understanding with "another country" but that he was "contending all the time with the lethargy of the Foreign Office". He was almost embarrassed at Britain's continued economic improvement while the rest of the world, and Germany in particular, seemed to be continually running downhill.<sup>57</sup> Nevertheless, he readily agreed that Leith-Ross should be allowed a free hand in order to fight the Germans as hard as possible.

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55. T 160 522 12750/017/1, British Embassy note of conversation between FLR & von Neurath, 25 Sept. 1934, FLR & Schacht, 26 Sept. 1934.

56. T 160 559 12750/020/1, Memo. 28 Sept. 1934, "Trade Negotiations with Germany", and minutes. CAB 24/250,218.

Leith-Ross did not feel compelled to revise his analysis when writing his semi-autobiographical Money Talks. He believed that anything like trade sanctions would have meant restricting British trade and compounding economic difficulties, while giving the Nazi party an excellent pretext for the anti-foreign propaganda on which it relied to justify the tightening of the German peoples' belts. Nevertheless, Leith-Ross reflects, Schacht was aware that the Reichsbank relied on the surplus of sterling received from the U.K., to finance the import of raw materials such as tin and copper. The Germans feared that under the operation of a clearing, Britain might refuse to allow the sterling to be used for any purpose other than the purchase of British made products.<sup>58</sup>

Thus the negotiations started with the avowed aim of setting up a clearing, but with considerable reluctance on both sides to take this step if some other acceptable method could be found. Moreover, British officials quickly became convinced that Germany would not make a satisfactory arrangement as to either past trade debts or future trade except as part of a clearing. Germany threatened to boycott British Empire trade if a clearing was unilaterally imposed; she was already attempting to obtain as many raw materials as possible through barter.<sup>59</sup>

On 3 October the Cabinet decided that negotiations with the German Government for a bilateral clearing office should be entered into, to operate from 1 November. The next day an inter-departmental meeting was held to discuss the draft order. The Treasury composed an estimate of the likely outcome of exchange requirements between Britain and Germany for 1934.

1) Exchange available	£m
Recorded c.i.f. value of imports from Germany	33
Less 8% for freights	2.5
	<hr/> 30.5
ii) Exchange required	
F.o.b. value of U.K. exports	16
Freights 10%	1.5
Re-exports f.o.b. less goods on through bill	10.5
Freights 8%	1
	<hr/> 29
Balance therefore available in Germany as a result of merchandise transactions	1.5 approx.

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III) Germany's financial requirements	£m
Standstill	2.6 (only 1.6 due London)
Interest on Dawes and Young	1.2
Interest @ 4½% on other loans	2.2

In addition the total outstanding commercial debt due to the U.K. from Germany amounted to £4.7 million. There was a total of 393 claims. The biggest was that held by the Anglo-Persian Oil Company, of over £500,000 for petroleum supplies.<sup>60</sup>

Reporting on the progress of Waley and St. Quinton Hill (Board of Trade) in Berlin, Pinsent noted that as they favoured the reduction of any clearing to vanishing point, they were purely play acting. He believed that the German motive was perhaps to exercise tighter control over exchange, but more likely to save face. These officials thought that public opinion in Britain could be satisfied if certain undertakings were secured from the Germans. This could be achieved, they hoped, without resorting to more forcible methods which could be reserved for the possibility of their opposite numbers not playing fair.<sup>61</sup>

Meanwhile in London, the renewed prospect of a clearing propelled the bankers to the attack once again. This time, in a letter to the Governor of the Bank, the Joint Committee sought to highlight the differences between British bankers and traders. The former, it was claimed, had never looked for the Government's aid in the collection of their claims. Rather, the Government had sought the co-operation of the bankers to abstain from collection - at a time when German capacity to pay was much greater than it had subsequently become. On the other hand, the debts overdue to British traders were incurred at a time when the German economic situation was known to all, and when the legislative restrictions and practical limitations affecting the provision of exchange was a matter of public knowledge. However, the bankers were concerned not to appear unsympathetic; but they wanted to secure as much protection for the claims of the financial creditors as for those of other classes. Finally, the Joint Committee expressed its by now familiar fear that a clearing would render a renewal of the Standstill at its maturity inequitable or impracticable, so that the bankers would also have to look to the Government for support.<sup>62</sup>

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57. NC18/1/891, letter to Ida, 13 Oct. 1934.

58. Leith-Ross, Money Talks, p. 184.

59. T 160 534 13460/010/1.

60. T 160 535 13460/010/1-2.

61. *ibid.* letter to FLR, 13 Oct. 1934.



However much influence the bankers had with Montagu Norman, and however much respect the latter could command in Treasury circles, Leith-Ross, for one, was not over-impressed by the combined weight. He took up the point of whether the Government was wholly responsible for the Standstill with his superiors in the Treasury. In his opinion, the bankers were between the devil and the deep blue sea in 1931: if they had not agreed to the Standstill arrangement Germany would have imposed a moratorium and the bankers would have been compelled to ask for protection. Thus, "the credits given to Germany have been maintained under the Standstill agreement as the only alternative to a complete breakdown". The effect of the Standstill was in fact, though not in form, to freeze up this volume of German indebtedness - all that Germany had really paid since 1931 was the interest.

Although it was recognised that German exports had tended to decline whenever a clearing arrangement had been made, and that this was a danger for the U.K. too, the Treasury continued to hold that a gradual liquidation of frozen trade debts by a per-centage of receipts from a clearing would not affect the Standstill. Leith-Ross suggested that if the Standstill did break down then something would have to be done to avoid a collapse of the discount market. Indeed, Hopkins thought that some of the big short-term creditors were undoubtedly genuinely frightened lest the end of the Standstill was in sight. He felt that in reply the Chancellor should at least acknowledge the Joint Committee's statements, otherwise he feared that they might become so frightened that they would refuse to take the bills any longer.<sup>63</sup>

Correspondence flowed between the Chancellor and the bankers via Governor Norman. But neither side completely accepted the other's arguments.<sup>64</sup> A major reason for Norman's concern over the turn of events stemmed from the fact that the Bank itself played a significant part in the business of the Standstill. Having decided to encourage and even sponsor London participation in the arrangement, the Bank did everything possible to ensure marketability.

The Bank of England held many of the bills which represented the greatest part of the credits given by London. The Governor's willingness to rediscount these bills was a necessary basis of the system so far as the City was concerned.<sup>65</sup> Indeed, in the first half of 1932 nearly one half of the bills discounted at the Bank were of German origin. Yet the Bank apparently disliked their artificiality, believing that for "as long as they circulate, the commercial bill is prostituted". There were ideas to follow the Dutch Central Bank

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62. T 160 534 13460/08, letter to Governor, 12 Oct. 1934

63. *ibid.* Memo by FLR, 12 Oct. 1934.

64. MB 30/191.

65. Clay, Lord Norman, p.449.

and launch an official operation to take the bills off the market. But it was feared that this would smack too much of governmental involvement and do more harm than good. Instead, the Bank opted to monitor carefully the implications of Standstill indebtedness in London. Professor Sayers maintains that while the Bank encouraged the "fiction" that it was proper for these bills to be held in the market, it was also remembered that firms, apparently six in number, especially dependent on their value might, at some time, need supporting.<sup>66</sup>

In the autumn of 1934 it seemed to some that that time had almost arrived. If the Standstill had broken down the City would have refused to deal in the bills and any default by the acceptors would have provoked a major crisis on the market. On 24 October the chairman of the National Provincial Bank, with which most of the acceptors banked, was called to the Bank of England, and Norman warned the Committee of the Treasury that the Bank might have to join in a rescue operation for four of the firms.

Some days earlier there was a further development in the negotiations in Berlin. The Treasury had always contemplated a clearing under which they would collect sterling from British importers and pay it as available to British exporters, and the Reichsbank would do the same. But the Germans were proposing that they should be responsible for all the operations except the first one. This seemed strange to the Treasury, when it was Britain which was imposing the clearing. Traders might think that putting their destiny in the hands of Dr. Schacht was taking things too far, and ask, why trust a German, even if you think you have him in your control? The Governor, Hopkins noted, would have taken just the opposite view. Norman was not concerned with the difficulties of political presentation or the suspicions entertained about the bona fides of Germany. Rather he saw the German proposal as a far more convenient technical instrument than a clearing.<sup>67</sup> Although the Treasury would have controlled any clearing when instituted, there was no desire to be solely responsible for the final decision over the procedure of a clearing. Chamberlain felt, at this late stage, that the issue was intrinsically one for the Board of Trade because it was the feelings of traders and maintenance of trade that were primarily involved.

But the German proposal was soon superseded by a different scheme offered by Schacht to Leith-Ross (now in Berlin). Schacht decried the need for a clearing and claimed he would carry through a scheme for liquidating the frozen trade debts. This involved raising a loan in London using as collateral outstanding sums due to Germany from England. Schacht also gave assurances about settling the claims of the coal, herring and textile exporters, and he agreed to maintain U.K. exports on some proportional basis. The British negotiators believed Schacht to be working towards a position in which he could say that it was Britain which was insisting on a clearing, as Germany could make satisfactory offers on all British claims except the Dawes and Young Loans. <sup>68</sup>

In London preparations went ahead to institute a clearing system; the draft text of the order was printed and special forms for traders prepared. On the 24 October the British delegation received revised proposals from Dr. Ulrich, one of Schacht's subordinates. Leith-Ross opined that if, in addition to this scheme Britain won a definite continuation of the Transfer Agreement, then the Government could claim to have secured "Peace with Honour". Britain would still have the power to impose a clearing in the following months. But Leith-Ross revealed that although he thought the Germans incredibly foolish to delay their offer until so late, his instinct told him to keep a clearing in reserve. If a clearing were imposed, Germany would suffer more, but direct damage would be done to London's credit business and the raw materials markets.<sup>69</sup>

Thus although the Government was most concerned to refute those arguments raised in London against a clearing, and to show a determined face to Germany, in reality its resolve was far from strong. Chamberlain, for example, revealed to his sister, "I have been having a very worrying time over this Anglo-German negotiation. Horrible possibilities of a German Default and the consequent bankruptcy of some of the great English financial firms have been hanging over me ever since I took office and just lately they have been very menacing." Yet, the possibility of reaching agreement would once more postpone the evil day.<sup>70</sup> As Chief Economic Adviser to the Government Leith-Ross was also exposed to all the warnings issuing from the City, and to the threats and excuses of the German authorities. Finally, the only justification which could be offered for not pressing on to obtain all the safeguards for payments in respect of current trade and frozen debts was that Britain would have to set up a novel, cumbrous and expensive machinery which many traders disliked and most bankers detested.

#### iv) The Anglo-German Payments Agreement.

Simultaneous negotiations were conducted right up until 1 November, when the Anglo-German Payments Agreement was concluded. Under the terms of this agreement Germany undertook to adjust imports from Britain, month to month,

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66. Sayers, Bank of England, p.508.

67. T 160 535 13460/010/3, Hopkins to Fisher and Chamberlain, 18 Oct. 1934.

68. *ibid.* FLR to Treasury and Board of Trade; Telegram, Ambassador Phipps to Secretary Simon, 19 Oct. 1934.

69. *ibid.* Telegram to Treasury and Board of Trade, 25 Oct. 1934.

70. NC 18/1/893, letter to Ida, 27 Oct. 1934.

to British imports from Germany. In fact, German exports were to bear to British exports a relation of 100:55. Even though this amounted to a substantial surplus for Germany, it meant that the volume of Anglo-German trade was theoretically determined exclusively by British initiative - Germany merely following suit. It was thus possible for British imports to be conducted on a free exchange basis, but the proceeds from this were to apply to current German imports and to the amortization of commercial and long-term obligations in pre-determined proportions.

Article 4 of the agreement bound Germany to make a payment of £400,000 to British trade creditors. Over and above this, Germany undertook to provide a monthly allocation (provisionally fixed at 10 per cent of the value of German exports to the U.K.), sufficient to liquidate the outstanding trade debts within twelve months. She also undertook to realise, by a credit operation or otherwise, the outstanding German claims on the U.K. The phrasing of this last clause was left deliberately vague.

The Payments Agreement was, therefore, in effect a modified clearing, but payments were made in free Devisen - perhaps a rather elusive concept in the case of Germany - in place of settlement by the offset of clearing balances. But Runciman, President of the Board of Trade, insisted that a clearing agreement had to be ready for initialling for inclusion in the agreement. He was not optimistic when announcing the agreement (a new technique in British commercial relations), and warned traders to be cautious.<sup>71</sup>

But the most remarkable feature of the agreement was the arrangement which developed out of Article 4. A few days before the signing of the agreement it became apparent that Schacht might ask Montagu Norman for a credit. On 22 October Hopkins noted that Schacht was preparing lists of British debtors which the Governor would appraise and then use to try to secure advances from the Joint-Stock Banks, each bank making advances in respect of debts of its own customers. But the Governor, who Hopkins thought was always a bit of a pessimist, believed that this operation would take three weeks. By 26 October it was decided to extend credit to Schacht and the concurrence of Norman with this new scheme was probably enough to persuade Treasury officials that a clearing could be avoided.<sup>72</sup>

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71. Cmd. 4726 & 4963. See also Ellis, Exchange Control, p.211; Richardson, British Economic Foreign Policy, p.78; Arndt, Economic Lessons, p.187.

72. T 177 20.

But Norman reserved the right to arrange the terms between himself and Schacht. He also desired to be absolved, in writing, from the ordinary wish of the Government that new credits should not be given to Germany. The Chancellor gave approval to this plan, and the Treasury believed that it also had the approval of the Foreign Office.<sup>73</sup>

On the day the agreement was concluded, Montagu Norman wrote to the Chancellor to confirm that Schacht had asked that if, during the currency of the agreement the Reichsbank needed funds in order to fulfill obligations connected with frozen debts and Sondermarks, whether the Bank of England would be prepared to discuss terms for an advance of up to £400,000. Chamberlain responded favourably to an idea which he thought would be in Britain's interests: "it is our strong hope that the present agreement will provide a solution of our difficulties with Germany." On the other hand he would not guarantee that any debt incurred by the Reichsbank would be immune from a future clearing.<sup>74</sup>

Privately, Chamberlain was delighted with the agreement which was very much better than he had expected. As before, he felt that Schacht had bluffed up until the last moment. Chamberlain was full of praise for the skills of Leith-Ross and Waley.<sup>75</sup>

Schacht had spoken freely of having claims on the U.K. totalling more than £5 million which he hoped, with the aid of the London bankers, to discount in order to pay off all Britain's frozen claims on Germany. But it transpired that they appeared to be seven to eight thousand small book debts, not a good basis on which to raise credit. Schacht complained that although he had already transferred £400,000, he had not been provided with a list of the British creditors to whom money was owed. One week after the signing of the agreement, British officials were still rather bemused by the Reichsminister's plans. The British Government felt that Schacht should at least attempt some kind of credit operation with the London bankers; if he failed he would then at least be free from this particular responsibility.<sup>76</sup>

For this reason Leith-Ross wrote to the embassy in Berlin. He informed them that the agreement had had a very good reception in Britain. Although Runciman

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73. T 160 544 13999/01, Hopkins to Fergusson (PPS to Chancellor) 26 Oct. 1934.

74. *ibid.*

75. NC 18/1/894, letter to Hilda, 3 Nov. 1934.

76. T 160 544 13999/01, FLR to Fisher and Chamberlain, FLR to Norman, 8 Nov. 1934.

had been very nervous about it, the atmosphere was positive; it had gone down well with the House, the City was delighted and traders were quite satisfied. Leith-Ross believed that there was no reason why the agreement should not work successfully as it was in the interests of both countries. But with Schacht's apparent abandonment of the credit operation, British ministers who, so it was argued, had only been induced to accept the agreement by the prospect of a large payment for frozen debts, were becoming uneasy.<sup>77</sup>

Finally, at the end of November, and only after Cobbold had telephoned Berlin, the Reichsbank proposed to honour its 10 per cent monthly payment to trade creditors by arranging a credit of £1 million with the Bank of England, thus making a total of £1.4 million.<sup>78</sup> Everything was to be repaid within a year. The British Government found this suggestion satisfactory as a larger distribution of outstanding debts could be arranged. On the other hand, it made the arrangement of a credit much more difficult for the Bank, because of the question of security. Yet the Bank, it was believed, had more effective means of securing repayments than the Government had in getting payments out of Schacht. So as considerable risk was involved only reasons of public policy could justify the Bank accepting the business. Fisher and Chamberlain agreed that the risk was indeed justified.

Initial support for the Payments Agreement seems to have been based on relief that a clearing had been avoided. The euphoria quickly dissipated as trade and government circles became aware that the agreement was not working well. References to a likely breakdown began to appear in the press. Leith-Ross wrote to Pinsent, "I have tried my best to keep the question out of discussion in the Press...but I must say that to some extent the situation causes me serious misgivings. The sondermark situation is full of mystery and I am not clear what is happening about the 55% allocation." His objective was to ensure that sterling was regularly paid over to a special account, to be drawn upon for the purposes of the agreement, and not diverted for other purposes. He was afraid that, "we left the actual administration of the arrangement too vague when we were in Berlin and that we ought to have fixed up a machinery of this kind."<sup>79</sup>

But by 4 December Schacht had managed to arrange a credit for £750,000 with the Bank of England. This was to be added to the £400,000 already paid and £264,000 made available representing the 10 per cent allocation for November. Although the agreement could now start to function, the Governor was, as

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77. *ibid.* FLR to Phipps, 8 Nov. 1934. FLR to Pinsent, 16 Nov. 1934.

78. T 188 179.



always, most cautious. He wrote to Leith-Ross that,

"It is bound to become public knowledge that Germany only makes the payments owing to the advance granted to the Reichsbank. On the other hand the conditions which permitted the advance to be arranged are by agreement held in secrecy between the Chancellor and myself. I think these two points are important: the former may be published abroad; the latter must be hidden".<sup>80</sup>

Indeed, the conditions were kept hidden. It seemed that the top officials at the Bank were prepared to go to great lengths to help "bury" the danger of a clearing by making the agreement workable. And the arrangement did indeed become public knowledge within a day or two. The Financial News claimed that the £750,000 credit had given rise to a good deal of criticism in commercial banking circles. It appeared to be a straight forward credit to the Reichsbank for a full year, with nobody but the authorities aware of the nature of the debts on which it was secured. The article speculated that the security given would not have been acceptable to a private banking consortium. Rather, it was, "sure to make British exporters more ready than before to sell to Germany on credit... when they find the authorities ready to take special measure to expedite payments .... to that extent it is almost certain to mean positive financial assistance to Germany." The article concluded by questioning whether the transaction was in accord with the Government's Parliamentary assurances that it was against public policy to extend fresh credit to Germany.<sup>81</sup>

This article was almost certainly from the pen of Paul Einzig. Indeed, this commentator came to regard the 1934 Payments Agreement as "the first act of economic appeasement".<sup>82</sup> While the long-term results of the agreement will be considered later, it is important to note that even by the beginning of 1935, the German authorities had rejected the original proposal to grant import certificates freely for English wares and had started to impose severe restrictions. Nor did the terms granted to British creditors undergo any improvement. Nevertheless, Germany continued to collect the considerable proceeds of her export surplus in free sterling.

Furthermore, the Treasury was mistaken in thinking that the agreement had the support of the Foreign Office. The latter maintained that they had not been consulted over, or kept informed about, the discussions which led to

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79. T 160 544 13999/01, 1 Dec. 1934.

80. *ibid.* Norman to FLR, 5 Dec. 1934.

81. Financial News, 7 Dec. 1934.

82. Einzig, Appeasement, p. 34.



the agreement. They were certainly not satisfied that the £750,000 credit was in the national interest (as Chamberlain had so described it in the House of Commons on 11 December). Sargent complained that the credit had been produced by Norman on security the nature of which they were not allowed to know. Sargent's impression was that the security was nothing more or less than a verbal "I.O.U." from Schacht. Vansittart added: "We ought at least to have some intelligible explanation of what is being done and why. We are not children".<sup>83</sup>

Vansittart was worried that the credit operation would create a precedent whereby the Bank of England would whenever necessary be expected, both by British exporters and German importers, to make good Germany's commercial bad debts. He wondered whether Schacht had been aiming to achieve such an object all along. While Leith-Ross fully shared Vansittart's suspicions about German policy and Schacht in particular, he fancied that Germany was anxious to clear up the commercial debts in order to carry on current trade. Furthermore, Leith-Ross remarked to Vansittart,

"I do not know whether you have ever attempted to raise money from the Old Lady, but my belief is that you would find her pockets very tightly buttoned up unless you could produce exceedingly good security....and I fancy that however Schacht might treat obligations to other people, he will be extremely anxious to keep faith with the Bank of England."<sup>84</sup>

It is now possible to trace the terms and course of the credit in the archives of the Bank of England. The credit was to be for a maximum of one year with interest at Bank Rate varying plus one per cent and repayment in sterling. The security was to be provided by approved external bills, covering the advance pound for pound with a margin of 10 per cent on sterling bills and of 15 per cent on bills in other currencies. The Reichsbank was to endeavour to arrange that at least 50 per cent of the collateral should always be in sterling bills. The bills were to be bona fide trade bills such as the Reichsbank would normally discount.

On 11 February 1935 the Chief Cashier, Peppiatt, noted that the advance did not look too happy as he estimated that at the end of the credit period there would be insufficient to repay frozen debts by £425,000, making with the Bank's advance a total deficit of £1,175,000. If this was to be liquidated, therefore, repayments needed to be increased. Siepmann had always reckoned that the Germans would be £1 million short of their undertakings. But he supposed that the advance was alright. Nevertheless, he immediately contacted

Reichsbank Director Puhl. On 19 February the Reichsbank swiftly paid back £200,000 and Puhl restored the balance of sterling bills to 50 per cent from the 37 per cent to which it had fallen. Siepmann thanked Puhl for the timely repayment. When, in August 1935, the Reichsbank reduced the credit balance to £150,000, Siepmann felt able to note that the situation was "extremely satisfactory, as was to be expected."<sup>85</sup>

At first sight, therefore, Britain narrowly avoided having to institute a clearing system for trade with Germany. Instead, the novel device of the Payments Agreement was erected. After several months of worsening trading conditions, this afforded a degree of protection to British exporters. Surprisingly, the British Government was willing to accept an unfavourable trade balance in relations with countries of North and West Europe, apart from Germany, in spite of the drive for increased exports. As Scandinavian states were unable to sell in Germany unless they bought there, it was to their advantage to divert orders from Britain to Germany. Sweden, for example, spent a large part of the proceeds of her export surplus with Britain in Germany. Thus British reluctance to channel trade by clearings not only had a direct effect on Anglo-German trade, but also indirectly helped Germany achieve a favourable balance of trade with other European trading nations.

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83. FO 17738 C8738, minutes, 11 & 12 Dec. 1934.

84. T 188 79, RV to FLR, 17 Dec. 1934. FLR to RV, 18 Dec. 1934.

85. BE OV34/85, note, 7 Feb. 1935; minutes by Siepmann, 18 Feb. & 12 Aug. 1935.

## CHAPTER VI

### Raw Materials and Credits: British Policy and German Rearmament

1934 - 37.

In the last chapter it was suggested that the banking community, fearing that the Standstill Agreement would be endangered, exercised a very real restraint on the move to erect a clearing agreement with Germany. The Bank of England records include a memorandum written by Professor Henry Clay before the Anglo-German Payments Agreement was reached. He hoped that in negotiations Britain would recognise Germany's difficulties as well as claim recognition of her own, and co-operate in any plan for restoring Germany's position in the commercial world.

Clay was not concerned merely to point out the dangers to the Standstill Agreement. Rather, Clay the economist, with the experiences of the immediately preceding years in mind, expressed the opinion that the economic fortunes of Britain, if not the world, were inextricably linked with those of Germany. He was in no doubt about whether Germany should be helped to become fat or whether she should be kept lean. The difficulties of Germany were largely due to internal economic policy; but only Dr. Schacht guaranteed economic stability and stood between this policy and something much more extreme and much more dangerous to the rest of the world. Germany was, after India, the biggest single market for British exports. If objection were raised that a substantial part of those exports were re-exports, then that only brought out the importance of Germany as a market for Empire exports. For exports of the U.K.'s own products Germany was the eighth largest market. But far more serious than the direct loss of a market, if Germany's trade or currency collapsed, would be the dislocation caused in the world generally. Germany's trade was not only larger than that of any country except the U.K. and U.S.A., but it was particularly widespread and diversified.

Clay thought, therefore, that it was in Britain's own interest to attempt to prevent such a collapse. But, like Phillips, he also suggested that Britain had a special responsibility: "The depreciation of our exchange hit them more than any other country because their export industries are mainly competitive with ours not complementary like the U.S.A.'s". For the same reason, British tariffs hit Germany exceptionally hard; trade agreements with Denmark, Poland, Russia and Argentina all tended to divert trade to the U.K. at Germany's expense.<sup>1</sup>

The thesis could not be clearer. Britain had the responsibility, means and

self-interest to help steer Germany back on to the course of economic liberalism. Failure to do so would result in severe consequences for the whole world. But, by late 1934, Germany had already started to rearm at a pace which appeared determined and showed no signs of slackening. How should Britain, provider of raw materials and finance, respond?

i) Rubber: The Case of The Dunlop Rubber Company.

In September 1934 the Governor of the Bank of England informed Sir Frederick Leith-Ross that leading raw material suppliers, (oil, soap, chemicals, metals, jute and rubber), were sending representatives to Berlin. The companies concerned were thought to include Dunlop, Unilever, I.C.I. and Tennant and Sons - ferrous metals and alloys. In the event, all except I.C.I. sent representatives. The group was led by the Unilever executive Rykens, who claimed that the visit had the blessing of the Board of Trade, which the latter denied. Nor did Leith-Ross much care for the plan; he thought that the object was to make propaganda for credits. However, he agreed with the Governor that provided reputable people went who were not specifically selected for their pro-German temperament, he did not see how the Government could raise objection to the visit.<sup>2</sup>

Towards the end of the month Leith-Ross received an angry report from the outspoken Commercial Secretary at the Berlin Embassy, Edwards. The unofficial British delegation of industrialists and traders had met Schacht ~~and~~ been received by Hitler on 20 September. Edwards believed that Schacht had sold them his point of view: Germany would shortly be back on her economic feet and all that was wanted was reasonable credit.<sup>3</sup>

Some days before the Berlin visit Leith-Ross had also been sent a letter from a member of the Rubber Trade Association of London, which had appointed a sub-committee to deal with German debts. The writer wanted the British, French and Dutch suppliers to unite to put pressure on Germany, especially as demand in that country was growing rapidly and world prices were better than when most of the running contracts had been made.<sup>4</sup> Leith-Ross also received (from Edwards), a copy of a letter this Association had sent to the German Rubber Controller, Dr. Hammesfahr.

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1. BE OV34/6, 3 Sept. 1934.

2. T 160 728 12750/012/2, FLR to SDW, 14 Sept. 1934.

3. T 160 573 13460/011.

4. T 188 147, Walter Fletcher to FLR, 5 Sept. 1934.

5. T 160 573 13460/011.

It was of particular interest, therefore, that included in the Berlin delegation was the Overseas Director of Dunlop, Mr. Proctor. Edwards accused the German authorities of attempting a big bluff. It seemed as if Proctor had departed with the firm idea that Germany could manufacture synthetic rubber. The Chief Economic Adviser's help was enlisted to disabuse anyone of such an idea. For, if the process was so easy and the product so remarkable, it was difficult to understand why the Rubber Controller should have been so worried about future deliveries of raw rubber. Leith-Ross readily believed that the trade representatives had been duped by Nazi propaganda. The Treasury would do its best to wake them up without giving the impression of attempting to blockade Germany.<sup>5</sup>

The specific proposals made to Dunlop soon emerged, but Leith-Ross noted that there was a good deal of gossip in business circles. He, too, found it difficult to believe Schacht's statements to him that the meetings had been of a purely social nature; some businessmen had enjoyed no less than seven hours of Schacht's company. It was alleged that a proposition had been formulated under which frozen debts would be paid up, and fresh deliveries made under new credits to be opened at the Bank of England by the Reichsbank, with a deposit of collateral. The nature of the collateral was said to be balances owned by Germans in England. Leith-Ross suspected that it boiled down to a desire by Schacht to draw on unavailed credits.<sup>6</sup>

However, the fact that members of the mission seemed to be keeping the proposals up their sleeves rather than bringing them into the open, led Leith-Ross to think that the discussions had been of the vaguest character. Perhaps Schacht's main objective, he wrote to Pinsent, in getting the people over, was to "nose around" and find out what the big British export firms were prepared to do. Whatever had taken place in Berlin, Vansittart regretted that a firmer line had not been taken initially; he wished "that the Governor had been a little more discouraging".<sup>7</sup>

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6. *ibid.* FLR to Chancellor, 2 Oct. 1934.

7. T 188 147, 4 Oct. 1934, and minute by RV. One result of the mission was the formation of the Anglo-German Fellowship which held its first meeting on 11 March 1935, (the Anglo-German Association had been dissolved in 1933 because it contained non-Aryan elements). The moving spirits were J. Piggott (British Steel Exports Association) and E. Tennant. Other founder members were Proctor, Rykens, F. D'Arcy Cooper (Unilever), Sir R. Kindersley (Lazards), A. Agnew (Shell Mex & BP), Prof. Conwell-Evans, M. Spencer (Price Waterhouse), A. Guinness (Guinness Mahon) and J. Evans (C.T. Bowering). The Fellowship proposed to send another mission to Germany. See FO 18878 C2168.

Unilever provided an illustration of Germany's policy of attempting to obtain extended credit terms. The company told the Board of Trade that it had received a proposal from an important textile group in Germany which sought very large loans in Credit Sperrmarks. The loans would be taken for five years, be repaid in Dutch florins (taking the marks at par), carry interest at 4.5 percent and be guaranteed by one or more of the large German banks. These Credit Sperrmarks belonged, of course, to the Dutch arm of Unilever, but, as the London representatives put it, such an international concern preferred to refrain from definite negotiations until certain opinion had been obtained. The Board of Trade, however, made it abundantly clear that any such loan would be regarded as a deplorable move. The proposal was dropped.<sup>8</sup>

A scheme which arose from Proctor's visit to Berlin was taken much more seriously. It concerned the Deutsche Dunlop Gummi Compagnie A.G. in Hanau. As the chairman of Dunlop was Sir Eric Geddes, it is, perhaps, not surprising that the Government became closely involved. Geddes contacted Sir Richard Hopkins and Montagu Norman telling the latter, "I think our minds are pretty clear as to our own attitude".<sup>9</sup>

In taking an inventory of the whole foreign exchange position, Schacht had decided not to give any permits for the import of rubber. Dunlop, with a very heavy capital commitment in Germany, feared that its plant - with three weeks' stocks of rubber - would have to close and would not be allowed to reopen. The Continental Rubber Company of Hannover (the national German company) had then proposed that Dunlop should provide it with rubber and other raw materials, such as cotton and carbon black, for the next three months at a rate of £160,000 per month. The German company would then resell, in Reichsmarks, 25 per cent of the amount to Dunlop's German subsidiary to enable them to continue production. Continental would then be responsible for reimbursing Dunlop in London in sterling at the end of three years, the Reichsbank guaranteeing payment of the bills.

Sir Robert Vansittart was quick to condemn the proposal. He told Fisher that there was, first and foremost, the strategic nature of the materials to consider. The Government's Industrial Intelligence Centre believed the materials were required in connection with the German motorization programme, of which the military aspect could not entirely be discounted. This was one reason why the Foreign Office had already discouraged efforts which were made in the City in August to send rubber to Germany on credit. Even Sir Eric Geddes had commented that, "tyres are, of course, by no means merely a peace-time product." Germany wanted cotton badly for domestic uses and for re-export, and British prices were the best. Nor did Vansittart think the Reichsbank guarantee worth

much. Geddes should be told that if he embarked on such business the Government would not help him recover his credit.

Moreover, the proposal implied the financing and bolstering up of the existing disreputable and dangerous régime in Germany, and even possibly its direct financing for war purposes. It had always been the Foreign Office view that everything possible should be done to "keep Hitler's Germany lean". Britain had had no reason to welcome the course Hitler had followed and consequently nothing should be done to help him continue. Vansittart pointed out to Fisher that the Treasury and Foreign Office together had done what they could to discourage the extension of credits of this kind by the oil companies. And, in personal vein, he concluded, "I think you are well aware of the essence of my views which I hold very clearly and definitely."<sup>10</sup>

Indeed, the Treasury needed little encouragement. Waley's opinions formed the basis of the document soon to be laid before the Cabinet. He considered Schacht's attitude and practice had been indistinguishable from blackmail for a long time. The Government should stand completely aside from the proposition. While not going as far as the Foreign Office, the Board of Trade also viewed with alarm the prospect of such a large expansion of new credits to Germany; there was an obvious risk of their being frozen.

On the other hand, Waley felt that it would be unreasonable to press objections to supplying Germany on credit to the extent of asking Dunlop to run the risk of losing the capital which they had sunk there. The blackmail would at least be reduced if Dunlop committed themselves to just one month's supply at the outset. Leith-Ross added that it was for the company to judge the commercial risk of the credit proposed, but at their own risk. While he could not believe these terms were necessary, he noted that the Governor was much more favourable and would not oppose the scheme from the economic standpoint.<sup>11</sup>

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8. T 160 573 13460/011, Browett (Board of Trade) to SDW, 29 Sept. 1934.

9. *ibid.* 28 Sept. 1934.

10. *ibid.* letter, 10 Oct. 1934. It is possible that the references in this letter to attempts to supply raw materials on credit is evidence of a concerted policy by the German authorities; there was an unsuccessful attempt to arrange some kind of Anglo-German trade agreement in April 1934, when German interests were negotiating in the City for long-term credits for oil, tin and rubber.



The Chancellor of the Exchequer told the Cabinet on 3 October that the Government had no power to stop Dunlop if it decided to proceed with the scheme. Instead, the Chancellor intended to tell Geddes that if his company could obtain permission from the German authorities to import such rubber and raw materials as were required for its own needs, there was no objection to the transaction. But it was also to be made plain that the Government disapproved of the particular scheme under consideration and that the entire risk rested with the company. Moreover, the Chancellor proposed to remind Geddes that a guarantee by the Reichsbank was not comparable to a guarantee by the Bank of England.<sup>12</sup>

While the Cabinet's decision was being communicated to Dunlop, the company received amended proposals. The period of delivery of raw materials was limited to two months instead of three, at a total value of £360,000; repayment was to commence in two years instead of three and to last twelve months; and Continental was to take 80 per cent of the supplies. After a meeting at the Treasury between Norman, Leith-Ross and Geddes, the latter wrote to Fergusson, the Chancellor's PPS, asking for the question to be reconsidered as he thought the amended proposals much more favourable.

The Continental Rubber Company had become, in Geddes' eyes, "our friendly competitor". What the chairman wanted now from the Government was an intimation that, while in no way accepting responsibility for the transaction, no action would be taken which would prevent repayment of the sum due from Continental, (such as a clearing). Geddes desired the Government's assistance and blessing for the scheme so that it could be carried through successfully. Dunlop occupied a position different from others in trade with Germany, "because we have been forced by their tariffs to manufacture in that country". If, on the other hand, such sanction was not forthcoming on patriotic grounds, then the company would suffer enormous loss of plant and skilled manpower.<sup>13</sup>

Leith-Ross explained the new proposals to Vansittart. The Dunlop subsidiary would be allowed to import its requirements and pay for them through ordinary reimbursement credits. Geddes still did not like the proposal, admitting that it was in the nature of blackmail, but as a business proposition he apparently felt that he would be unwise to turn it down. Leith-Ross had told Geddes that as the subsidiary was subject to German national law, there was no way in which the British Government could offer it any protection. It seemed, to Leith-Ross, very hard for the Government to tell Dunlop to close down the factory and, "write off this important British investment", if the company were prepared to accept the commercial risks involved. If the Government told them to shut down for political reasons, there might be far-reaching reactions of all kinds in both countries. Leith-Ross felt the company

should make the best terms it could.<sup>14</sup>

It seems, however, that the Treasury was most concerned that, when there was something of the order of £6 million in frozen credits already in Germany, fresh credit should be granted, especially under the kind of pressure being applied. Even though Dunlop had explicitly rejected the idea of ever asking for assistance, there was great reluctance to add to the list of traders who might seek governmental aid in respect of payments from Germany. There was also the question of precedent. It seemed as if Germany would attempt to obtain additional credit in other directions in a manner similar to that attempted with rubber. The Treasury also feared that companies like Continental might not continue to have sufficient foreign exchange (with the development of clearing arrangements between Germany and other countries), to honour their commitments. And with such great liabilities, little faith could be placed in the Reichsbank's guarantee; Dunlop might then only receive Reichsmarks.

It was decided that the Government would have to stop such blackmail tactics if they were continued or extended as contrary to the national interest, even at the expense of the loss of subsidiary companies operating in Germany. But Chamberlain agreed that it was not possible to take such a firm line in this particular case. Justification had, therefore, to be found for non-intervention. Rather than worry about the principle involved, it was felt that the transaction was now too small and the military use too doubtful and indirect for it to be stopped on grounds of national defence. A further point apparently worth considering was the importance of saying nothing which would allow Geddes to tell his shareholders that they had lost their investment because of the Government's disapproval of the company's proposal.<sup>15</sup>

Consequently, Geddes was told that the new proposal made the matter too small to justify governmental intervention on patriotic grounds. The principle of a transaction, under which the British nationals were persuaded by a foreign government to provide credits of an exceptional character - not required for purposes of their own business but for the benefit of that foreign government's own economy - was condemned. Yet the Government were not keen to elevate

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11. *ibid.* Memo. by SDW, 1 Oct. 1934.

12. CAB 23/79, 33(34)3.

13. T 160 573 13460/011, 5 Oct. 1934.

14. *ibid.* FLR to RV, 5 Oct. 1934.

15. *ibid.* Memo. for Chancellor by Fergusson, 5 Oct. 1934.

the problem into a question of principle as far as policy was concerned. In answer to the request from Geddes, therefore, the Government would neither extend moral support and assistance, nor would it exempt Dunlop from any action which might have been required in consideration of the national interest. The chairman would doubtless have been comforted to know, however, that the Chancellor fully recognised that the case of British companies with foreign subsidiaries presented special difficulties.<sup>16</sup>

The view from Berlin was somewhat different. Edwards did not feel constrained to write in the usual official style to protest against what he saw as a case of lunacy in an advanced form. He informed Leith-Ross that the managing director of Hanau was the German brother-in-law of Proctor, and warned that the granting of ludicrous credits would hamper Britain in its negotiations to reach a settlement with Germany. If the latter felt she could get raw materials so easily, Britain would have very little hope of getting foreign credits paid at all. Edwards concluded, "If I were a shareholder of Dunlop's, I would suggest that the directors be publicly flayed for considering such a proposal".<sup>17</sup>

Montagu Norman also decided that Proctor had either completely misunderstood the whole matter or had been bluffed by the Continental company. Norman had spoken to Schacht at Basle. The latter claimed he had no details, but maintained that the Reichsbank could and would not guarantee sterling payments two years in the future; he said that it was impossible to give the undertaking which Proctor alleged he had received, that after two months Dunlop Hanau would be guaranteed foreign exchange for its normal imports. And while Schacht had also said that there would be no discrimination against Dunlop Hanau, he maintained that the German Government might take over its factory, or any other tyre factory, if production stopped.<sup>18</sup>

The Continental Rubber Company did indeed drop out of the picture, which led the Treasury to think that they had either misunderstood what the Reichsbank had been prepared to give them by way of a guarantee or that they had been indulging in a heavy piece of bluff. Instead, Dunlop Hanau negotiated an agreement with the Rubber Controller and the Reichswirtschaftsministerium for direct supply of raw materials. For a period of four months (rather than two), the company undertook to provide itself with raw rubber, raw cotton and American gas black, (1,130; 460; 168 tons respectively), to a total value of £120,000. As repayment, in sterling, was to be by 1937, credit was extended over about two years.

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16. *ibid.* Fergusson to Geddes, 8 Oct. 1934.

17. *ibid.* Edwards to FLR, 6 Oct. 1934.

Geddes informed the Treasury that the Dunlop board considered it a prudent investment. He still hoped that when the time came the Government would assist the company in obtaining repayment through credit or a clearing. In considering their reply the Treasury thought that the agreement was not open to exception and that a good many similar ones had gone through without any communication to a government department. Nevertheless, the Board of Trade did not want Dunlop to be led into thinking that officials were prepared to put the company into the same class as trades receiving preferential treatment such as coal, herring and textiles. Consequently, Fergusson merely pointed out to Geddes that rather than undertaking to give special support to the company, the Chancellor would give such support as might be given to similar trade debts.<sup>19</sup>

It is difficult to assess exactly what business resulted from the visit to Berlin by the British mission. In a satirical despatch Pinsent related how Schacht was representing the visit as a typical example of the way in which relations of perfect confidence could be maintained or created when the British Government did not intervene to spoil the love scene. Schacht was claiming that foreign businessmen were falling over each other in their eagerness to sell raw materials to Germany.

Pinsent also reported a scheme in which Hambros Bank were interested. Credit would be provided to enable Germany to purchase Egyptian cotton, security being taken on German exports - probably machinery rather than finished cotton goods - to Egypt. It had to be taken into account that a transaction of this kind would place the German Government in a better position to put pressure on Egypt to buy German goods as a condition of selling their cotton. If British exports were displaced in this process (which might encourage German dumping), deals of this kind would be open to a lot of criticism in England. Pinsent opined that it was obviously difficult for British banks to refrain from taking part in such transactions if the terms were proper. He pointed out, however, that German efforts to promote barter transactions were only likely to succeed if German exports could be forced on foreign countries at the expense of third countries including the U.K. <sup>20</sup>

Although this particular scheme does not appear to have been put into operation, Hambros were involved in another kind of transaction. At this time, the Treasury thought it well to ask the Bank of England to discourage any

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18. *ibid.* minute by Fergusson, 10 Oct. 1934.

19. *ibid.* Fergusson to Geddes, 29 Oct. 1934.

20. *ibid.* Pinsent to FLR, 9 Oct. 1934.

new assignments of amounts payable to Germany in respect of exports of German goods to the U.K. It was thought that any new credit-givers would be confined to houses such as Hambros, Lazards and Barings. The Bank of England complied with the request.<sup>21</sup>

But as a result, Olaf Hambro became concerned about the credit of £1 million his bank had granted to I.G. Farbenindustrie earlier in the year. The object of the credit was to finance I.G. trading with Britain, the Dominions and other countries with free exchanges. The conditions were that whenever the company drew on the credit they informed Hambros of where the goods were consigned, and sent a letter from the buyers irrevocably undertaking to remit the proceeds in sterling to the bank. The credit was a revolving one - I.G. could draw at three months' sight on the bank at any time - but the bank kept the right to review the credit at the end of one year. The problem was that Hambros intended to continue the credit; it had worked smoothly resulting, so the bank believed, in a considerable turnover in trade with Britain and the Dominions. The question was whether the right to terminate credit meant that the credit constituted a new one, and how a clearing would affect the credit.<sup>22</sup>

It was recognised in the Treasury that such arrangements provided necessary foreign exchange for Germany, but that they would also prove a nuisance in the event of a clearing. If such credits were extended, a large proportion of the income of a clearing might be absorbed by the claims of the accepting houses. If the credits received official approval any exports covered by them would have to be excluded from a clearing. Accordingly, Philips wrote to the Governor to point out that as approximately 30 per cent of the I.G. credit was secured on German exports to the U.K., nearly all those exports would come within the scope of a clearing. It was hoped that, with this in mind, Hambros would reduce their credit to the amount covered by I.G. exports elsewhere. Soon after this, Waley noted that the City had quoted the Government to the German Embassy over the matter of new credits which might facilitate German rearmament. That the reaction of the Germans had been to comment on such an "unfriendly attitude" was taken to be all to the good that policy had been made clear.<sup>23</sup>

But it is doubtful if there was a clear policy at all. A little more than six months after the request to the Bank of England concerning new credits to Germany, Leith-Ross had occasion to comment on reports in the Financial News that Schacht had approached the Bank for a fresh credit. Siepmann denied that there was a shred of truth in the story and asked if there was anything the Treasury could do, "to moderate the damage done by Einzig's inventions".

Phillips noted that the Bank had made more than one effort to "scrag" Einzig in the past: "The fact is that he has a long term contract with the Financial News and even if we were on good terms with the editor and proprietors, which we aren't, they couldn't do much to help." As regards counter-publicity, Phillips thought the Bank could put up their press friends to deny that the Bank had ever contemplated a new credit to Germany. The Bank of England was one thing. But emerging from this exchange Leith-Ross wrote, "I do not think that we can object to fresh business being done on normal 3/6 month credit; indeed, it was one of the arguments that I addressed to Schacht that if he settled his frozen debts satisfactorily, merchants would resume business on the normal credit terms."<sup>24</sup>

The policy of restricting new credits to Germany seems, therefore, to have resulted as much from the problem of frozen debts as from the threat posed to Britain's security by German rearmament. So long as war matériel was not concerned and frozen debts were liquidated, the Government was not going to forbid new credits to Germany. But officials had to decide the degree to which they would sanction trade in commodities which had a real or potential role to play in the German rearmament effort. Yet, as the Dunlop affair shows, it was the manner in which the company was treated by the German authorities which caused most excitement in Britain. The fact that rubber was of direct military value was subsidiary. Indeed, if difficulties had not been created for Dunlop Hanau, the question of supplying Germany with rubber at all would probably not have arisen. It looked, at first, as if the Dunlop matter would prove to be a test case. But, as the succeeding months were to show, each case was decided individually.

#### ii) Oil: The Case of the Anglo-Persian Oil Company.

The question of supplying raw materials to Germany received no greater attention than over the problem of mineral oil exports. In terms of strategic value oil, of course, had already assumed its place as facile princeps among raw materials. The large oil groups, Standard Oil, Anglo-Persian Oil and Shell supplied Germany with the bulk of her imports of oil. The latter two - with their subsidiaries Olex and the Asiatic Petroleum Company respectively - accounted for some 30 per cent of the trade.<sup>25</sup>

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21. T 160 573 13460/012, SDW to Holland-Martin, 14 Oct. 1934, and Holland-Martin to SDW, 10 Jan. 1935.

22. *ibid.* Olaf Hambro to Norman, 20 Dec. 1934.

23. *ibid.* letter, 28 Dec. 1934; undated minute, SDW to FLR.

24. T 160 728 12750/012/3, Phillips to FLR, 18 May 1935 and minute by FLR, 17 May 1935.



The German Government invited the oil companies to provide all the current requirements of Germany and to build up a large reserve on credit, with no chance of receiving any appreciable payment in foreign currency for at least five years. In return, the Germans would give some undertaking to limit production of synthetic oil, and to maintain the market for the oil companies.

The Treasury wanted the frozen debts of the Anglo-Persian and Shell paid; they amounted to £845,000. Vansittart was more agitated. He thought that the Anglo-Persian should be told to approach the other companies with a view to taking a far stronger line vis-à-vis Germany. They should insist on being paid 100 per cent for their supplies and should not countenance the giving of any new credit. Vansittart promised that the Foreign Office would give all the support in its power to secure joint action. The American Ambassador could be approached to bring pressure on Standard Oil and the British Government could influence Deterding of Shell. Vansittart also thought he could speak to the Russian Ambassador with considerable prospect of success. The Foreign Office would not be worried if the Germans became aware of Britain conducting these diplomatic negotiations, nor did Vansittart think that the threat of Germany producing her own supplies or of throwing over the Anglo-Persian separately needed to be taken seriously.<sup>26</sup>

It seems as if the Anglo-Persian was worried initially at the lack of solidarity with the other companies. But they became more determined to act alone if necessary. Perhaps this was because an inter-departmental committee, called to consider the plan, had decided that it was unacceptable.<sup>27</sup> Leith-Ross wrote to Sir George Barstow, Anglo-Persian's chairman, to pass on the government's whole-hearted approval of the company's rejection of the scheme and the contracts proposed for the special reserve. Leith-Ross also told Wigram that the company would only hold three months' stock, that they would insist on 90 cent cent of the c.i.f. price of the oil delivered to Olex (10 per cent accounting for Olex's commission), in foreign currencies. The company had also decided not to enter any contract exceeding two years.<sup>28</sup>

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25. CAB 24/248 CP 83, CID Sub-Committee Report, Oct. 1933, 'Economic Pressure on Germany'.

26. T 160 602 12750/09, SDW to FLR, 25 July 1934.

27. CAB 24/251, CP 252, 'Supplies of Petroleum to Germany', 9 Nov. 1934.

28 T 160 602 12750/09, FLR to Barstow, 26 July 1934, and to Wigram, 25 July 1934.



But within a few days this resolve seemed to have weakened. Leith-Ross heard from the Anglo-Persian that the companies would probably continue to supply without getting cash, as they each had a big amount of capital locked up in Germany and were bound to be prudent about taking action which might result in business shutting down. The Asiatic Petroleum Company submitted a memorandum to illustrate the commercial point of view. Germany's requirements for oil supplies, in line with the development of aviation and especially motor spirit and diesel oil for the motorisation programme, were projected to rise sharply. A comparison of motor traffic utilisation was drawn between Germany and countries of similar importance in terms of population and industrial activity.

Estimated Petroleum Consumption in 1933.

Population in millions.		Tons
U.K.	48	3,960,000
France	41	2,500,000
Germany	66	1,500,000

The Asiatic had already built up a considerable investment in Germany - some £17 million of immovable assets - and it was looking to expand. If terms were not agreed it was feared that not only would the German Government increase production of synthetic oil but the position of the companies, with their large investments, would become very difficult.<sup>29</sup>

While Deterding reported that the Board of Shell, at a meeting at The Hague, had agreed to accept no proposals objectionable to the British Government, Leith-Ross found the company's position "lamentably weak". They appeared to have agreed to an indefinite postponement of cash payment. This brought the despairing reaction from Vansittart that just as one could not make empty sacks stand upright, if the companies did not have the stuff of resistance in them, government departments would not be able to put much in. The Treasury reasoned that if the oil companies looked at the position from a commercial point of view it would be very difficult to change their minds in order to secure a political end. The government directors of the Anglo-Persian were not supposed to interfere with the commercial administration of the company. Nevertheless, when, some weeks later, the Treasury recorded the formation of a new Anglo-German oil company (to exploit the German oil fields), it was noted that none of the companies would have anything to do with the German proposals. It was suggested that some discreet pressure exercised by the Foreign Office was responsible.<sup>30</sup>

The German authorities, however, were not so easily deterred. Representatives of I.G. put forward alternative proposals. This involved the creation of a satisfactory cartel arrangement to govern selling conditions in the German market. I.G. wanted the oil companies to supply oil products to the value of £4 million for delivery over five years (with I.G. having the option to call for the whole delivery in two years), so that a reserve stock could be built up in Germany. With each cargo 10 per cent of the f.o.b. value would be paid for on arrival; the balance would be paid for by six monthly instalments over the period of the five years.<sup>31</sup>

The inter-departmental committee considered the new proposal. The arguments were set forth in a memorandum for the Cabinet. The Anglo-Persian had reported that, "we have an important distributing organisation in Germany and provided always this deal could be arranged on sound commercial lines, our share in the carrying through of it might avoid the loss of goodwill to us, which is important in the present situation in Germany." The committee appreciated that, if immediate cash payment were insisted upon, it would be difficult for Germany to obtain oil supplies, because of her exchange position. It was also pointed out that Germany would be able to secure oil supplies through other channels and through further development of her own resources. The latter already provided her with about one third of her requirements of motor spirit (1½ million tons). Domestic production of natural petroleum amounted to 300,000 tons, but was increasing with the German Government subsidising further searches. I.G. already operated a large hydrogenation plant at Leuna and planned more.

The strategic questions had to be weighed very carefully. The Foreign Office desired to call attention to the possibility of supplies being used as an emergency reserve - as with the original proposal which was rejected. Yet it was felt that, provided transactions were carried out satisfactorily from a commercial point of view, there was a good deal to be said for not taking any action which would force the German Government to undertake an intensive campaign designed to meet the greater part of her oil requirements from her own resources. For such a course would strengthen Germany's defence position - despite the fact that it would imply a diversion of effort from other important forms of activity - and the British oil organisation, on which the country would have to depend during any emergency, would be correspondingly weakened. The conclusion was reached that there was no clear grounds of public policy on which the Government could advise the Anglo-Persian to reject the proposal. It was agreed that it would be suggested to the company that they should secure the deletion of the condition as to delivery within two years, or at least that the payment and delivery terms should conform to one another.<sup>32</sup>

On 14 November the Cabinet considered the subject. There was agreement that the arrangements contemplated would greatly strengthen Germany from the military point of view by the provision of a substantial oil reserve; it might also give Germany possible opportunity to develop her internal production of oil and arrange alternative external supplies. Nevertheless, the Cabinet decided that it was preferable for Germany to remain dependent on external sources for her oil requirements rather than that she should be driven to rely entirely on her internal production. The recommendations of the inter-departmental committee were therefore endorsed. 33.

Unfortunately, it does not appear to be possible to trace, in governmental records, the outcome of these negotiations.<sup>34</sup> But it seems likely that little came of this scheme. For, at the end of the year, yet another proposal was put to the oil companies. The Treasury heard that I.G. were trying to do a deal for the supply of £1 million worth of aeroplane oils as a reserve. The Foreign Office would have liked to put every obstacle possible in the way of such a transaction, but I.G. were offering the guarantee of first class British Houses, so that from the point of view of the companies, the business would be good. The Anglo-Persian would be responsible for about one fifth of the total, Shell and Standard the rest.<sup>35</sup>

This provides a succinct illustration of the dilemma facing those concerned with the policy towards a rearming Germany. It continued to be open to debate whether aiding the German economy through any type of trade would strengthen the so-called extremists in the Nazi régime, making the danger greater for Britain, or whether it would render them impotent and thereby reduce the danger. And, of course, the debate was at its keenest where trade which might aid a potential enemy power to re-equip and rearm its military forces was concerned. For here the dangers were the greatest. In most cases, however, the primary consideration was that British financial and economic institutions should continue to develop their powerful position in the world economy.

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29. *ibid.* Memo. 30 July 1934.

30. *ibid.* Treasury/FO correspondence, 1 Aug. 1934. Perowne to FLR, 12 Sep. 1934.

31. CAB 24/251, CP252.

32. *ibid.*

33. CAB 23/80, 40 (34).

34. The BP archives department has stated (to the present writer) that the company's records appear to contain no reference to these negotiations.

35. T 160 573 13460/012, FLR to Phillips, 23 Dec. 1934.

Quite soon after the conclusion of the Anglo-German Payments Agreement, the oil companies reported difficulties in obtaining the necessary foreign exchange certificates. Article II of the agreement stipulated that the German authorities should produce proof that out of the total foreign exchange allocations there was sufficient for the purchase of British goods of customary proportions. But the agreement gave the German authorities the means of exerting pressure on the oil companies to come to some agreement over supplies. The justification offered by Germany for the restriction of certificates was that the products in this case were not of U.K. origin, even though it had been agreed previously that oil refined in Britain would so count. At one point, the Anglo-Persian threatened to divert cargoes already bound for German ports if certificates were not forthcoming. 36

By February 1935 the Berlin Embassy reported to the Board of Trade that Olex was on the point of shutting down. The accumulation of evidence showed that Anglo-Persian were being discriminated against. They had been told by the German authorities that they had to buy more goods in Germany to offset their oil debts - just as Shell and Standard were doing.<sup>37</sup> Barstow informed the Treasury that negotiations involving these latter two companies had been practically concluded, but that his company had dropped out as payment for current supplies had still not been received. Indeed, the chairman warned that if conditions in this respect did not improve soon, supplies would be stopped. He added that although cash payment had been stipulated in the Shell and Standard negotiations, he did not think that the two companies were particularly content.<sup>38</sup>

In the succeeding months, the Anglo-Persian (from 1936 the Anglo-Iranian) Oil Company continued to exist from hand to mouth for supplies for its German subsidiary. Moreover, against their will, they were obliged to take more and more supplies from Romania. According to Schweitzer German imports of oil rose 116 per cent from 1934 to 1937. But by April 1936 Olex was only managing to keep its petrol pumps going, which represented 50 per cent of normal trade. Most of the oil supplies now came from Romania, which meant - under the German-Romanian Payments Agreement - that Germany supplied oil plant to Romania, instead of Britain supplying plant to Iran.<sup>39</sup>

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36. T 160 615 13999/07.

37. *ibid.* Mines Dept. to Board of Trade, 7 March 1935.

38. T 160 602 12750/09, SDW to Wigram, 26 March 1935.

39. A. Schweitzer, Big Business in the Third Reich (Indiana, 1964), p. 304; T 160 615 13999/07, Petroleum Dept. to Board of Trade, 1 April 1936.

iii) Textiles: The Case of the Lancashire Cotton Corporation.

The textile industry provides one further example of the nature of the trading conditions which existed between Britain and Germany in the aftermath of the Anglo-German Payments Agreement. The cotton industry, like most of the staple industries, was heavily committed to the export market; in 1925 it accounted for 25.8 per cent of total exports by value. But by 1937 this figure had dropped to 13.1 per cent - a dramatic illustration of the scale of the problem confronting British trade.<sup>40</sup>

It is in this context that a proposal, advanced this time by a British industrialist, should be viewed. The managing director of the Lancashire Cotton Corporation, Mr. Platt, devised a scheme for barter trade between Britain and Germany. He told the Board of Trade that his policy was to increase his company's sales ability in Germany by direct trading with the users of cotton yarns there.

He professed that his object was greater employment in Britain through lower selling prices as a result of such direct selling. He believed that this type of business was being done in very many instances, but in a very haphazard and aimless manner, making it difficult to arrange. Suggestions for compensation agreements were constantly being put to him by his customers, he claimed. Thus Platt wanted to systematise the whole position.<sup>41</sup>

St. Quinton Hill considered the proposal. He did not see that government could object to this "institution of private clearing" as it involved an equal exchange as between U.K. and German products. There was, moreover, an added argument that U.K. exporters could no longer be sure of getting foreign exchange certificates. Schröders in London told Platt that their Berlin office would be able to make the necessary arrangements with the German exporting interests, which were I.G., the Steel Trust, and Siemens-Schücker. The Board of Trade and the Treasury did not approve of barter in principle but, in the circumstances, felt that they could not and even should not stop Platt.<sup>42</sup>

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40. S. Glynn & J. Oxborrow, Inter-War Britain. A Social and Economic History (1976), p. 73.

41. T 160 559 12750/033, Platt to Browett (Board of Trade), 28 Jan. 1935.

42. *ibid.* St. Quinton Hill to SDW, 29 Jan. 1935 and to Rawlins (Berlin) 31 March 1935.

Apart from the Lancashire Cotton Corporation, there appeared, in general, to be a strong movement towards barter transactions at this time. There was a danger for both Britain and Germany that if barter increased there would be little left over for the monthly 55 per cent allocation under the Payments Agreement. It had also become a fairly regular practice for Germany to pay higher prices for goods imported on barter deals. The German Government therefore began to forbid most of the transactions involving direct exchange of German for U.K. goods.

But Platt's ideas had only received a temporary setback. In September 1936 he put forward a new scheme to sell cotton yarn to Germany. The bankers who were to provide the credit had asked for approval from the Bank of England. C.A. Gunston (Overseas and Foreign Department), in turn contacted Waley saying that the bankers were to receive security for the transfer of the sums required to pay the credit. To a transaction so safeguarded, the Bank had no objection: there had been and continued to be other similar transactions. As the Germans were to convert the yarn into cloth for export, the Bank also did not consider the suggested credit term of nine months to be unreasonable. Indeed, Gunston continued, if it was decided to disallow this transaction, the Governor had asked whether the bank could be given some precise indication of the kind of transaction, to which no objection would be taken. He desired to know what commodities and what credit terms would be regarded as normal in the abnormal and unprecedented conditions under which British trade was being carried on with Europe generally and Germany in particular.<sup>43</sup>

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43.T 160 673 13999/018.

But the Board of Trade found several objections to the scheme. They, and the German representatives who together formed the consultative committee to oversee the smooth working of the Payments Agreement, had devised a provisional programme, an elaborate system for the six months ahead showing the amount of foreign exchange certificates for each trade. The amounts made available under the 55 per cent allocation, to be distributed between the various trades, were in the same proportions as in the year 1932-33, subject to specially favourable treatment for certain goods. The Board of Trade was most concerned that nothing should be done to disturb this arrangement. There was also the danger of frozen debts piling up again. Nor did the officials want the Germans "to start on the same game" as the Russians - always trying to get British goods on larger and longer credit. It was thought too, that any increase in the Lancashire Cotton Corporation's share of trade would mean a corresponding diminution for other companies. Jealousy already existed between Platt's company and its rivals; the latter alleged that special favours had been shown to Platt because of the influence of the Bank of England. Platt attempted, therefore, to devise a scheme which would be acceptable to the Board of Trade.<sup>44</sup>

Some two months later Platt's new proposal was before the Treasury. The company proposed to sell cotton waste to Germany for £50,000 over a year, outside the 55 per cent allocation. Hambros Bank were to pay the company in cash and receive obligations of the Dresdner Bank in nine or ten months. It was noted that before 1931 such sales were effected on 30 day credits. Nevertheless, Professor Clay hoped that the Treasury would not raise any objection. He thought that the exports would not be used for rearmament purposes, and that the banks had to be encouraged rather than discouraged to assist industry in this way. Waley felt that, "an embargo on commercial credits to Germany, if too strictly applied, does more harm than good politically, besides interfering with legitimate export business."<sup>45</sup>

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44. *ibid.* SDW to Hopkins, 1 Oct. 1936. There does appear to have been some connection between Platt and the Bank. Platt Brothers & Co., (machinery makers to the textile industry), were being reorganised and rationalised under their chairman, Walter Preston, the friend of the Governor. See Cambridge University Library, Baldwin papers, Vol. 32.

45. *ibid.* SDW to FLR & Phillips, 3 Dec. 1936.



With Treasury approval Montagu Norman wrote to Sir Charles Hambro to say that it would be in order to open such a credit, although it was important that the credit should represent genuine commercial transactions under normal banking conditions. Six months later the Governor wrote again to give his approval for Hambro to open a non-revolving credit for a further £100,000 on account of the Lancashire Cotton Corporation. Hambro did indeed open a credit (apparently for £50,000), and the scheme duly went ahead.<sup>46</sup>

iv) Compensation Brokers Limited.

Hambros Bank and Schröders were involved in a further scheme, the outline of which survives in the government records. On 17 November 1936, an inter-departmental meeting, chaired by Leith-Ross, discussed a plan for the formation of a company to be called 'Compensation Brokers Ltd.' It was to be run under the auspices of the two banks and its object was to organise the export of German goods primarily to Dominions and colonies, and to use the proceeds to finance purchases by Germany of raw materials. It was hoped that the exports would be non-competitive with British exports, and that the development of contacts and agreements between industrialists in both countries might be facilitated. It was reported that the German authorities welcomed the scheme.

There were, of course, important suppliers of raw materials to Germany who were unable to get payment for the commodities they had sold. Therefore, German exports needed to be stimulated. The idea was that Compensation Brokers would find foreign buyers for German exports, and arrange payment in sterling for importers of raw materials into Germany, in close co-operation with the authorities there. The company would also contact suppliers who were prepared to grant subsidies to German exporters, while Schröders and Hambros were willing to grant acceptable credits to sound buyers of German goods. Tennant and Sons would act as selling agents on behalf of the German principles. The scheme's backers felt that this would all help Germany to escape from the economic impasse and semi-isolation in which she was caught, and that as political difficulties would thereby be lessened, they imagined the scheme would be welcomed in official circles in Britain.

The meeting of civil servants heard how F.C. Tiarks (of Schröders) had written to the Governor to support the scheme. Tiarks claimed that such business was already being carried on extensively in an unregulated manner by all sorts of agents, many of whom did not have the Empire's interest at heart and had extracted extortionate premiums in connection with barter business. The Empire required many manufactured articles which could not just then be supplied by Britain, but were available in Germany. Compensation Brokers would ensure that war materials were not supplied. Tiarks added, in an ideological vein

guaranteed to appeal to the Governor, "you will readily understand how difficult it is to carry on business when such ordinary commercial transactions have to be explained and submitted for approval." Tiarks concluded that it was Government policy to promote every practical way of enabling Germany to obtain access to raw materials and bring her back into the sphere of normal international trade relationships.

The meeting did indeed consider whether government had the right to interfere in such business activities. There was also concern that if the scheme was vetoed, Germany would take it as an act of British duplicity - claiming to do one thing but doing another in practice. On the other hand, a popular outcry was feared if the scheme received approval. But the consensus was that the scheme was fundamentally vicious. It represented a great extension of the barter principle, to which the Government was certainly opposed. German competition was already severe, and although the raw materials might not themselves be war materials, the officials were afraid that developing facilities for one type of material might make facilities available for other types. Neither did the departmental representatives want anything to interfere with British re-exports to Germany, then worth about £7 million. As for plans for expanding trade in the Dominions, these were chiefly the concern of the Dominions themselves; there was already a trend of increasing trade between the Dominions and Germany.

But finally, the meeting considered the proposal in the light of political relationships. Alternative policies were posed as questions. Did the Government wish to prevent any new arrangement between British interests and the German Government pending some political settlement with Germany? Or did they wish to prevent such an arrangement only if, in the opinion of the Treasury, it involved some kind of loan or credit to Germany? As those present decided they did not desire to actually veto the scheme but rather to make it plain that there would be no government co-operation or support, the first question was probably answered with a no, the second with a yes.<sup>47</sup>

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46. *ibid.* 3 Dec. 1936 & 22 June 1937.

47. T 177 20.

The Foreign Office was particularly concerned to throw cold water on the scheme, which Vansittart thought was "sheer lunacy" and "suicidal" and was sponsored by "the two arch-German propagandists in this country", Tiarks and Piggott. What the Foreign Office wished to prevent, Sargent noted, was the City of London giving Germany loans or credits which would artificially relieve Germany of the penalty which she was paying for having sacrificed her national economy and foreign trade to the intensification of her rearmament. On 26 November Anthony Eden, the Foreign Secretary, wrote to the Chancellor of the Exchequer in an attempt to discourage the scheme.<sup>48</sup>

The refusal to give official support to the scheme considerably reduced its chances of success, not just in the event of difficulties with Germany, but also because the business establishment would treat it with suspicion. Indeed, British industry was not happy at the emergence of Compensation Brokers. The FBI had to write to its members to reassure them that it had been in touch with the new organisation to get assurances that every effort would be made to safeguard British export interests throughout the world.<sup>49</sup>

From the cases documented above it is possible to draw a tentative conclusion concerning the evolution of Government policy towards raw materials and credit for Germany. Paul Einzig has claimed, in a somewhat vague and unspecific manner, that a number of banks granted new credits to Germany in 1936 and 1937, of amounts **modest** in comparison to Germany's total outstanding liabilities. He maintained that, as a result of persistent criticism in the press and in Parliament during Spring 1937, the Bank of England sent out a circular, at the Treasury's request, asking the banks to abstain from granting any new credits to Germany. Einzig believed that when such credits were used for financing raw material purchases, resources were released which facilitated German rearmament. He also claimed that even firms engaged in German rearmament (like I.G.) received credits from London houses.<sup>50</sup>

From the City Nigel Law supplied the Foreign Office with information on this subject which he admitted was "hardly more than well-authenticated rumours". Several banking houses had granted short-term credits outside the Standstill. It was, of course, unnecessary for them to obtain permission from the Foreign Loans Committee. Law considered that most credits were for exports from Germany, and that they did not create but only anticipated the foreign exchange which Germany would eventually obtain. He thought it highly unlikely that any open credits had been granted even by the most pro-German of London firms. Only those credits which were capable of being used or misused as working capital could be considered as creating foreign exchange. Thus Law did not think that the City was providing money for the purposes of German rearmament.<sup>51</sup>

It would seem, therefore, that some banks, such as Hambros, continued to grant new credits into 1937, to finance new business between the two countries. But the amounts concerned were certainly small and the transactions carefully monitored by the Bank of England and the Treasury. Generally, it would appear that very little new business of this kind occurred after the Bank of England's discreet requests late in 1934, even though the Treasury seemed to retreat somewhat from such a hard line some months later.

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48. FO 19936 C8070/C8261.

49. Modern Records Centre, University of Warwick Library, FBI Archive (hereafter FBI), Economic Adviser's papers (Glenday files) No. 7, 5 Jan. 1937.

50. Einzig, Appeasement, p. 77.

51. FO 19932 C3524, 6 May 1936.

## CHAPTER VII

### British Policy in the face of German Trade Competition, 1936-37.

There appear to be two related reasons why British economic policy occupied the foreground in the debate over policy in general towards Germany in 1936 and 1937. The first was that in the middle years of the decade the advantages won earlier for British exports over German exports were gradually eroded as the latter began to enjoy the benefits of Nazi subsidies and clearing agreements with other countries. Indeed, in third country markets, British exporters had to face increasingly stiff competition from Germany. Just a few days before Hitler made the first move in the territorial revision of Europe, an English company, Textile Machinery Makers, complained to the Department of Overseas Trade that through German export subsidies they were being completely shut out of continental and near eastern markets.<sup>1</sup>

So began a process which led, later in 1936, to a major review of the problem of Anglo-German trade competition. For, as Henry Clay pointed out in 1934, Britain and Germany competed strongly against each other in the international market place. Such world-wide trading experiences occupy an important place in the complex network of factors which helped to form British policy to Germany. The effects of that policy were felt, in turn, in the markets of the world in the latter half of the 1930s.

German competition was a trend which contemporaries were able to identify clearly. It was estimated that some 80 per cent of Germany's foreign trade was conducted under clearing, payment, or barter agreements. In terms of marks, total exports were still less than in 1932. But exports had begun to receive not only indirect subsidy through the sale of Register marks but direct subsidy as well, so that it was believed that the average subsidy on all exports amounted to 20 per cent, while on some exports it reached 40 per cent. However, it was also thought that such an external economic policy acted to moderate the rigours of the internal economic position of Germany. The pace of the internal economic recovery was thought to have slackened. With the rate in the reduction of the total unemployed slowing, crisis was predicted, even though the German economy was clearly not on the point of collapse.<sup>2</sup>

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1. T 160 643 8797/04/6, 27 Feb. 1936.

2. CAB 27/599, note by Ashton-Gwatkin, 'Present Economic/Financial Situation in Germany', 28 Feb. 1936.

Related to these issues was the second reason why British economic policy received so much attention. A proposal, which originated in the Foreign Office and caused a great deal of excitement in the other interested departments of government, was put forward that an initiative in the economic sphere might provide the means of creating an Anglo-German understanding and thereby pave the way for the political agreement which had remained so elusive.<sup>3</sup>

Policy formulation was, of course, influenced by the interpretation officials placed on the sometimes scanty and inaccurate statistical material at their disposal. Similarly, while it is therefore necessary to have an indication of the trends in the overseas trade of Britain and Germany, a few qualifications should always accompany the reproduction of such statistics. It should not be assumed, for example, that in statistical comparisons methods of compilation were identical on either side, or even that identical components are being measured. Export and import indices in particular have to be treated with caution.

In Germany the New Plan had begun to accomplish the tasks for which it had been called into being. Exchange control continued to be the linchpin of the whole system. Ellis claims that if the case for devaluation was strong in 1933, it was ironclad in 1934 and 1935. The justification of exchange control had to be shifted completely from monetary and financial matters. Instead, exchange control determined the non-economic character of Germany's international trade - its volume, direction, and composition. Germany erected a fictitious currency unit which imposed the necessity of multifarious ad hoc, but concealed, devaluations.<sup>4</sup> In practice the New Plan involved a great extension of bilateral trading and many barter compensation deals were also carried out. In addition, an extensive system of private compensation agreements grew up which assumed several different forms. 'Aski' marks were frequently employed in the transactions. Between 1936 and 1937 Germany expanded her exports in finished goods by 23.3 per cent in value.<sup>5</sup>

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3. The initiative came from Ashton-Gwatkin. He believed that a weak Germany would be far more dangerous than a strong Germany which would also be one of Britain's best customers. He also felt that the Payments Agreement was in the economic world what the Naval Agreement had been in the political sphere - a sign of moderation, almost of friendship. See FO 18851 C7752, Memo. 21 Nov. 1935.

4. Ellis, Exchange Control, p. 244.

5. Guillebaud, Economic Recovery, pp. 68 & 148. Aski was an abbreviation for Ausländer-Sonderkonten für Inlandszahlungen.

No doubt such practices contributed to the process of the short-circuiting of London's trade services: the City suffered greatly as a result of the general reduction in international trade. Whereas Britain enjoyed a surplus of £359 million in invisible items in the Balance of Payments in 1929, the total had fallen to £219 million in 1931. Within these totals, income from Financial and other services was down from £65 million to £30 million. Perhaps the most important loss was the diminution of income from British overseas interest, profits and dividends which declined from £307 million to £211 million. 6

Coal occupied an equally significant part of the overseas trade of both Britain and Germany. Coal, together with coal and tar dyes, accounted for some 10 per cent by value of total German exports between the wars. Faced with the challenge of Britain's devaluation in 1931, Germany made drastic reductions in her coal export prices. This, the severe limitations placed on imported coal by France, Belgium and Germany (Britain's major export markets), and exchange restrictions, prevented the full advantage of devaluation from being realised. By the mid 1930s the level of British export prices was virtually the same as in 1930, whilst German and Polish prices were, respectively, more than 50 and 40 per cent lower than at the start of the decade. Thus, due to the continued low level of its export prices after 1931, the German industry achieved an export record during the 1930s which was far superior to its British counterpart.7

Such a development did not escape contemporary recognition. A drop of over 2.5 million tons was reported in S. Wales exports in 1936. The greater part of the loss was through German competition - widely believed to have been subsidised.8 In the same year, in France and Scandinavia, Germany gained more ground than the U.K. and the latter also lost markets to Germany in Spain, Egypt, Palestine and Greece.9

But perhaps the most striking development of all in the foreign trade patterns of the two countries, was Germany's increasing politico-economic interest in south eastern Europe. With the difficulties in making purchases from strong currency countries, Germany consistently and persistently drifted away from importing from west European creditor nations. It was with S.E. Europe that Germany developed the most extensive barter and bilateral trading system. As a result Britain was supplanted in the trade with the region. Germany increased her share of Turkey's import trade from under 18 per cent in 1929 to 44 per cent in 1937. Britain's share dropped from 12 to 7 per cent. In Bulgaria Germany raised her share from 30 to 58 per cent, while Britain's dropped from 10 to 5 per cent. In Greece Germany's share increased from 10 to 30 per cent.10



i) The Reaction to German Trade Expansion in South Eastern Europe.

At the end of January 1936 Frank Ashton-Gwatkin and Gladwyn Jebb, of the Foreign Office's Economic Section, circulated their memorandum on whether Germany had to "expand" in the sense of securing new external markets. It was an attempt to deal with Nazism by attacking its cause which, they assumed was, "obviously, economic distress". The need to expand was brought about partly by the extreme rationalisation and concentration of German industry. The thesis, put simply, was that Germany had to be provided with outlets for trade to prevent her from going bankrupt and thus starting a European war.

The document attempted to show that an expansion of German exports was essential if internal pressure was to be relieved, and that the "natural" direction for such expansion was toward central and south eastern Europe. The alternative to providing for German expansion was preparation for a general European war. For, it was held, there was no doubt that Germany would be so strong that she would prefer war against an Anglo-French-Russian coalition to internal bankruptcy. Apart from restoration of colonies to Germany, the Foreign Office authors believed that the only real possibility of averting conflict lay in the hope that a growing German export trade to S.E. Europe would act as a beneficial safety-valve. Britain could assist such a natural tendency by some kind of mutual self-denying ordinance, whereby she renounced her Most Favoured Nation Rights in return for limitation by Germany of competition in Scandinavia and the Baltic. Existing commercial policy would thus have to be moderated or reversed.<sup>11</sup>

This memorandum caused great excitement among officials. E.H. Carr (Head of E. Department) agreed with the idea of an initiative in S.E. Europe.

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6. C.H. Feinstein, National Income, Expenditure and Output of the United Kingdom, 1885-1965 (Cambridge, 1972), T.84, Invisible Items (Balance of Payments).

7. N.K. Buxton & D.H. Aldcroft, eds. British Industry Between the Wars (1979), pp.51-5.

8. League of Nations, British External Economic Policy.

9. The growing strength of German firms in a number of cartels won them increasingly large areas of Europe as their exclusive market.

10. E.V. Francis, Britain's Economic Strategy (1939), p.278. In Brazil, Chile, Venezuela, and Peru, Germany also made gains at Britain's expense, although the trend was reversed in the Argentine, N. Europe, Scandinavia and Russia.

11. FO 19884 C807.

Laurence Collier (Head of N. Department), on the other hand, did not. Instead, he agreed with Sir Eric Phipps that nothing should be done to help Germany out of her economic difficulties which were of her own making, and feared that political would follow economic penetration. Vansittart held that a political settlement had to precede the economic considerations suggested. If a settlement were reached then there might be good grounds for recognising openly what was already to some extent a fact: German economic preponderance in central, but not south eastern, Europe. Similarly, he viewed any scheme for swapping trading rights in one area for another as far too dangerous without a political settlement.<sup>12</sup>

A Colonial Office official, Clauson, declared that the memorandum revealed typically muddled and unrealistic thinking, presumably on the part of the Foreign Office. Yet Clauson demonstrated some magnificently muddled thinking himself. He thought that Germany's problem was political and that in any solution, therefore, the economic accompaniment had to be subsidiary - by giving Germany benefits which she would forfeit by embarking on a war of aggression. But, at the same time, nothing should be done to relieve Germany of the economic disabilities which appeared to preclude her from embarking on any large war of aggression. It is difficult to imagine, however, economic benefits which, once bestowed, would not relieve economic disabilities.<sup>13</sup>

In the Treasury Waley opined that the economic abandonment of Austria would be a volte-face, shocking to the British and French publics. The financial stake of British capital in Austria was, moreover, some £25 million. O'Malley, of the Foreign Office's Western Department, riposted that he was already entirely resigned to the fate which awaited Austria and Czechoslovakia - to be swallowed by Germany - as the majority of their German-speaking populations wanted it. He also thought that there was as much chance of getting money back from an Austria so absorbed as from an independent Austria.<sup>14</sup>

Nevertheless, Waley did not believe that the economic question was the prime motive of German action or that a solution was to be found in granting economic concessions. Phillips, too, pointed out that very many of the causes which had led to Germany's plight were irresistible in the sense that they could not be put right in the early future. For example, the adoption of protectionism by Britain hit Germany very heavily, but Britain was not going back to free trade. Phillips also wondered what would happen when Germany was forced off her monetary base.<sup>15</sup>

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12. *ibid.* C85, minutes by RV, 3 Feb. 1936.

13. T 160 856 14545/1, minute by C.T. Clauson, 15 Feb. 1936.

Such ruminations were reflected in a memorandum which stated that the removal of economic distress would not necessarily lead to the removal of the régime. Nevertheless, an economic restoration of Germany was perhaps the most helpful step that could be taken towards the "appeasement" of the situation. Relative to 1913 German wages were nearly 30 per cent higher than British and it was doubtful whether the concealed depreciation could be taken much further. But it was a possibility that devaluation of the mark would occur if world prices continued to rise or the gold bloc collapsed, which was possible at any time. 16

From Berlin Pinsent added his comments to the debate. He also thought that the Nazi movement would not be weakened by a consideration of economic factors alone. Yet, there was much which could be done on the economic side: "I take it as obvious that so far as we have an economic policy vis-à-vis Germany at all, it should be to help her rather than to hinder." But to what extent and in which direction? Pinsent's view was that there was no reason why Britain should go far out of its way. For many reasons a loan would be quite inappropriate: Germany would be unable to service it and might use it for rearmament, the political effects would not last long (Pinsent seemed to ignore the devastating effect of the Depression on Germany in thinking that the Young Loan had not stopped the Nazis winning power), and public opinion would be against it. As far as commercial expansion was concerned Pinsent did not see any advantage in trying to canalize Germany's trade in advance; this could lead to an undesirable concentration of influence. Rather, to follow a policy of economic understanding with Germany it was necessary to look nearer to home. A contribution Britain could make would be to moderate its own tariff policy. Pinsent believed the time had come when general considerations, more particularly those of foreign policy, should be allowed a far greater weight in the determination of U.K. tariffs. He felt that there was widespread support for the idea that Britain had far more to gain in the long run by an increase in the exchange of goods than to lose in the short run by intensified German competition in particular commodities. After all, the basis of the Payments Agreement was that British exports to Germany expanded automatically with the German exports to Britain.<sup>16</sup>

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14. *ibid.* O'Malley to SDW, 27 Feb. 1936.

15. *ibid.* Treasury minutes, 17 March 1936.

16. *ibid.* Unsigned Memo. 'German Expansion'.

17. *ibid.* 7 March 1936.

As the international outlook began to darken and Britain began to count the political and economic costs of her rearmament, a Cabinet Committee on Germany was formed to consider approaches to the problem of reaching an agreement. At its first meeting on 17 February, 1936, Anthony Eden laid before the Committee a paper in which he had written,

"It is only in the economic and financial spheres that Hitler's policy has not proceeded according to plan, and is now having to face extensive and maybe insuperable difficulties... Perhaps Hitler's economic difficulties may make him less uncompromising than he otherwise would be".<sup>18</sup>

Also before the Committee was the memorandum by Vansittart (subsequently widely quoted), 'Britian, France and Germany', and its covering note by Eden. The premise to Vansittart's hypothesis was that the economic distress which Germany was undergoing could prove to be the prelude to military adventure, as was the case with Japan and Italy. It was necessary to counter such a policy and, in principle at least, co-operation rather than obstracism was more likely to be successful. After all, without some German recovery there could be no full recovery from the world crisis. But Vansittart appended a rider: Britain should not go out of its way prematurely to finance a bankrupt, in some respects a fraudulent bankrupt, still less a ~~megalomaniac~~ bankrupt. By trade and payment agreements Britain had shown willingness in the economic sphere. Such agreements were appreciated in Germany and there could be no doubt that a further advance was desired. Vansittart believed that if the U.K. was to retain the large measure of influence and considerable friendship which it still had in commercial and financial circles in Germany, it was essential that trade was not reduced - by tariffs on Britain's part - except for pressing needs of industry. The insistent German claim for export markets was in itself a not unreasonable one, he declared.

One reason for the demand for expansion was the steadily declining export totals for the previous seven years in Germany. In terms of central Europe Britain had only protested at German expansion, but provided it took place gradually and pacifically, such a special area could be an objective of British policy, even if not publicly admitted. Finally, Vansittart warned, an economic solution could not precede a political solution, of which it was only a part, "and the easier and less dangerous part to boot".<sup>19</sup>

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18. CAB 27/599,CP 13(36).

19. *ibid.*CP 42(36), 11 Feb. 1936.

Eden took the arguments a stage further. In emphasising Vansittart's views he posed the fundamental question: who could be sure that if Britain assisted German economic recovery the latter would not rearm further? For this reason, Eden admitted, "Our dilemma is acute". Although there would be no sops offered to Germany, substantial concessions might be made, but only in the context of a general agreement. In thinking what to offer Germany Eden enumerated the facets to the problem: colonial, economic, financial, political and geographic. Was Britain prepared, for instance, to recognise that Germany should have special trading advantages in areas such as the Danube Basin? And was the country prepared to surrender its Most Favoured Nation Rights in order to bring this about? In certain circumstances could Britain consider a guaranteed loan? Or return of colonies? Was the Government prepared, more particularly if the German Government devalued the mark, to resist the probable pressure from interested parties demanding further exclusion of German goods from the U.K. market?20

Throughout the following days the arguments swung back and forward among the departments and their political chiefs. A test case immediately presented itself. A decision had to be made on whether to increase U.K. duties on dressed leather imports, most of which came from Germany. The IDAC, taking the interest of domestic producers into account, recommended an increase. Unusually large quantities of calf leather had been imported at prices which appeared to bear little relation to production costs.

Eden was against increasing duties. He quoted figures to suggest how U.K. duties and the fall in sterling had already hit German exports to Britain.

German exports to Britain in million Reichsmarks.

1929 - 1,305	1932 - 446	1935 - 360 (Est.)
1930 - 1,219	1933 - 406	
1931 - 1,134	1934 - 383	

The Germans were satisfied with the working of the Anglo-German Payments Agreement, but not with the increase in U.K. duties. Eden feared German counter-measures if Britain further reduced Germany's foreign exchange. Yet the most important point for Eden was that the Foreign Office, at that moment, was engaged in an examination of the possibility of making a last determined effort to reach a European settlement in agreement with Germany and France, and did not want anything to jeopardize that process.

The President of the Board of Trade objected. There was already resentment at the delay in coming to a decision. The evidence suggested that Germany subsidised its dressed leather exports to about 35 per cent of value and forced exporters to sell abroad at any price. The combination of these factors

was apparently driving British producers out of business.

The Cabinet decided to let commercial, or rather domestic political, conditions prevail. It was felt that not to impose the extra duty would have been politically dangerous: a storm of acute criticism and resentment might have been provoked. Chamberlain sided with Runciman. He saw great difficulty in telling traders that their application had passed all the tests of the IDAC but failed at the last minute because of political considerations. He feared that agitation against the foreign policy which produced such results would render it so unpopular as to destroy the Government's support for it, just when it was most needed.<sup>21</sup>

Just as Runciman was able to prevail over his Cabinet colleagues in this specific case, so his department, in consultation with the Colonial Office, argued against all the options which had been countenanced for a policy initiative in respect of Germany. The Board of Trade had no intention of denouncing the May 1933 trade agreement with Germany. Although its reception by British industry had been hostile, no damage had been done. The 3 million tons of coal exports to Germany were noted with satisfaction.

The Board of Trade also completely rejected the possibility of tariff reduction in the existing climate, or of altering the Payments Agreement ratios. There seemed to be, therefore, "no possibility of making commercial arrangements with Germany which will alter her political outlook and render less likely the dangers of which we are aware." It was observed that Germany had increased import duties herself in the previous three years on a number of exports from the U.K. As for a gesture such as renouncing the Most Favoured Nation Rights in S.E. Europe, it was to be greatly deprecated - it would have a serious effect on the U.K., world trade, and set a dangerous precedent. Similarly, the taking of measures to assist Germany's export trade to the colonial Empire was thought to be impracticable.<sup>22</sup>

In the Colonial Office the extraordinary Clauson produced a vitriolic attack against the memorandum 'Britain, France and Germany'. Vansittart was variously characterized as being alarmist, betraying the ideals of the Colonial Office, encroaching on territory not his preserve, and exaggerating

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20. *ibid.*

21. CAB 24/260, CP59-60, 24-25 Feb. 1936; CAB 23/83, 11(36), 26 Feb. 1936. Significantly, arrangements were made, on Chamberlain's instructions, to improve the process of consultation between the FO and the IDAC, in order to spare the Cabinet the difficult task of having to resolve such issues.

the German menace. At the same time, Clauson displayed a revealing enthusiasm for continental concessions to Germany. So far as the U.K. was concerned the strategic and economic considerations were strongly in favour of such a course of concessions, he wrote. The English should have had some sympathy with German racial aspirations. And if everyone was satisfied that Germany was shortly going to be the greatest power in Europe, did not worldly wisdom dictate that Britain should book a seat in the German bus before it was too late?23.

The proposals put forward by Ashton-Gwatkin and Gladwyn Jebb at the beginning of the year and interpreted by Vansittart and Eden had, therefore, gained little ground before Hitler reoccupied the Rhineland on 7 March 1936. Ideas concerning any agreement with Germany underwent drastic revision. The possibility of taking economic sanctions against Germany was even discussed. But the Treasury quickly vetoed any proposal that the Locarno Powers alone should attempt trade reprisals on Germany. Phillips thought such an idea farcical because Britain would lose £40 million on Standstill money and damage her own trade more, and because there would be dozens of loopholes through which Germany would get the goods she required. Sir Warren Fisher dismissed the notion of sanctions with no more than the thought that, "Even Alice in Wonderland would regard the idea as lunacy".24

It was in these circumstances that renewed criticisms of the Payments Agreement appeared in Einzig's 'Lombard Street' column in the Financial News. It was left to Waley to attempt to refute the claim that the Agreement left Germany with a balance of £10 million for arms expenditure. He produced the following figures.

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22. CAB 27/599, G(36)7, 'Possible Development of existing Commercial Agreements with Germany as regards the U.K. and Colonies'.

23. T 160 856 14545/1, 6 March 1936.

24. T 160 935 13456/2, Minute, 17 March 1936, on 'Report for CID Sub-Committee:- Economic Pressure on Germany.'



£'000's

U.K. exports to Germany - 18,994	U.K. imports from Germany - 30,044
" re-exports " - 7,457	
	Balance - 3,643

Out of which Germany had to meet:-

Interest on Dawes and Young	1,600
Interest on commission on Standstill	1,600
Service of Potash Loan	0,600
Interest of 4% Funding Bond	0,200
Liquidation of frozen debts	3,000
	Unfavourable Balance 3,500

Waley estimated that the situation from 1936 would require Germany to have a balance of £4.1 million in order to pay the U.K. bondholders in full. But it looked as if the figure would be only £2 million. He believed that the agreement was working satisfactorily for British trade - exports to Germany had increased from £14 million in 1934. Interest to British holders of Dawes and Young Loans was being paid in full. Altogether, it would have been against British interests to have denounced the agreement. Even if the clearing which had been initialled at the time of the agreement, were put into effect Germany would continue to have 45 per cent of the sterling at her disposal (which mostly would be required for financial claims and re-exports). Thus, in order to deprive Germany of this, a so-called 100 per cent clearing would have been needed. Yet, Waley did not stress the fact that frozen debts were being quickly liquidated, although he did deny that officials had proposed that the 10 per cent under the agreement which was no longer needed for these debts should be used for the benefit of the bondholders.<sup>25</sup>

Moreover, notwithstanding the evidence of these calculations, the agreement had proved to be of special value to the Reichsbank; it assured the Germans of their one considerable source of free foreign exchange. As Ashton-Gwatkin implied, while the agreement constituted a satisfactory settlement, for the time being, of commercial and financial questions, just as importantly it was regarded, in British circles, as a useful contribution to good political relations.<sup>26</sup>

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25. T 160 543 13900/08; Financial News, 29 June 1936.

26. CAB 27/599, G(36)2, Ashton-Gwatkin Memo. 28 Feb. 1936.

ii) The Reaction to Uneconomic Competition by Germany in the World's Markets.

The focus of attention of Britain's economic relationship with Germany shifted considerably in the course of 1936. Before the occupation of the Rhineland, the concept of achieving a political understanding through the means of economic concessions to Germany was actively discussed. Although the German economy was perceived to be entering a crisis phase, German attempts to expand export markets were viewed as a possible opportunity to achieve agreement. Many officials held the view that as Britain's agreements with Scandinavia and Baltic countries had deprived Germany of those countries' markets, Britain should leave the thorny path of central and eastern Europe to Germany. By the middle of 1936 the Economic Section of the Foreign Office tried again to stimulate interest in the idea of an initiative in the economic sphere. Anthony Eden attempted to pursue the question of a U.K. tariff reduction. But in late August 1936 Walter Runciman decreed that Eden's proposals were a complete reversal of the policy taken by the Government since 1931. Imperial Preference and moderate protection in the home market had been twice endorsed by the electorate - in 1931 and 1935. To abandon that policy for the sake of an "initiative" would, Runciman believed, only create trouble at home without securing any real advantages abroad.<sup>27</sup>

In the course of 1936 policy-makers began to take a more defensive posture in the debate over Germany for reasons other than the purely political. The effects of German external economic policy were such that by June 1936 the Department of Overseas Trade was receiving reports of a number of important contracts where the U.K. firms tendering had experienced intense competition from German concerns. This had resulted, in some cases, in the business being lost or in U.K. prices being forced down to uneconomic levels.<sup>28</sup>

In response, the Board of Trade produced a 'Survey of German Competition in World Export Trade'. The survey attempted to assess the extent of German competition with the U.K. in overseas markets, particularly as a result of special assistance given by the German Government through, a) redemption of debts; b) clearing and compensation accounts including Aski accounts; c) trade subsidy; d) barter.

Just as clearings had been imposed on Germany by countries with which Germany had an export surplus, so Germany imposed clearings on other countries, with whom she had an import surplus.. In 1935 an estimated 60 per cent of exports in the world, including the bulk of European trade, were paid for through clearings or similar arrangements. This was reflected in the fact that world export trade in 1935 had fallen by about 40 per cent in gold values and 8 per cent in volume since 1931. In the same period Germany's exports fell by over

55 per cent in value and 14 per cent in volume, while the gold value of U.K exports fell by about 30 per cent but the volume actually increased.

Not surprisingly, U.K. traders were meeting the greatest competition from Germany in S.E. Europe and also in Central and South America and China. In the British Empire the most serious competition was in India. Particularly affected by loss of business to Germany were the locomotive, internal combustion engine, agricultural and textile machinery trades. German export trades were attempting to recapture lost ground: figures published by the Reichs-Kredit-Gesellschaft showed that of the combined value of engineering products exported by the three chief suppliers, (Germany, U.K. and U.S.), the German share fell from 45 per cent in the second half of 1932 to 28 per cent in the first half of 1935. The report found that in the case of tinplate and chemicals, it was probable that cartel arrangements reduced competition. There had been suggestions that arrangements of this nature could serve to modify competition but not much progress had been made apart from the Iron and Steel International Agreement.<sup>29</sup>

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27. FO 19933 C4757; FO 19934 C5567, Runciman to Eden, 23 Aug. 1936.

28. FO 19933 C4326, Sir Edward Crowe (Comptroller General, Dept. of Overseas Trade), to RV, 13 June 1936.

29. T 160 729 12829/2.

Comparison of U.K. and German Export Trade. 30(A) Shares of United Kingdom and  
Germany in World Export Trade.

(including also U.S.A. figures for purpose of comparison)

<u>Year</u>	<u>Gold Values (millions of Gold Dollars)</u>	<u>U.K. Share</u> %	<u>Germany's Share</u> %	<u>U.S. Share</u> %
1913	18,195	14.08	13.21	13.46
1924	25,127	14.01	6.19	17.90
1929	33,021	10.75	9.73	15.62
1931	18,908	9.37	12.09	12.58
1932	12,895	9.92	10.60	12.22
1933	11,740	10.37	9.88	10.90
1934	11,364	10.47	8.62	11.03
1935	11,444	10.83	8.9	11.6
1936 (1st qtr.)	2,781	11.19	9.74	12.08

(B) Value of United Kingdom and German  
Import and Export Trade.

	<u>Germany</u>		<u>Imports</u>	<u>United Kingdom.</u>	<u>re-Exports</u>
	<u>Imports</u>	<u>Exports</u>		<u>Exports</u>	
	<u>Million Mkks.</u>			<u>(£1000)</u>	
1913	10,770	10,097	768,735	525,254	109,567
1924	9,135	6,533	1,277,439	800,967	139,970
1929	13,447	13,483	1,220,765	729,349	109,702
1931	6,728	9,599	861,253	390,622	63,868
1932	4,667	5,739	701,670	365,024	51,021
1933	4,204	4,871	675,016	367,909	49,081
1934	4,451	4,167	731,414	395,986	51,243
1935	4,159	4,270	756,936	425,921	55,265
1936 (1st half year)	2,111	2,243	402,801	207,890	32,407

(C) Distribution of United Kingdom and  
German Exports to Continental Groups  
as Percentage of Total exports.

(a) Germany

	<u>1913</u>	<u>1926</u>	<u>1931</u>	<u>1934</u>	<u>1935</u>
Europe	75.0	71.0	81.0	76.4	71.6
Asia	6.2	9.4	6.6	9.4	10.9
Africa	1.9	2.5	1.9	2.5	2.9
America	15.0	16.0	10.0	10.8	13.7
Australasia	1.0	.7	.4	.6	.7

(b) United Kingdom

	<u>1913</u>	<u>1926</u>	<u>1931</u>	<u>1934</u>	<u>1935</u>
Europe	34.65	26.29	43.29	38.62	37.27
Africa	9.86	12.00	12.85	14.15	15.37
Asia	25.20	25.24	17.91	18.13	17.43
America					
(a) North and Central	11.99	14.18	12.18	11.97	12.81
(b) South	9.59	8.93	7.06	7.49	6.93
Oceania	8.71	13.36	6.71	9.64	10.19

NOTE: The approximate figures of German and United Kingdom exports to Europe were:-

	<u>United Kingdom</u> <u>(£ millions)</u>	<u>Germany</u>
1931	169	388
1935	158	235

Although extensive research went into the making of the survey, there seemed little immediate activity following its circulation. Euan Wallace, Secretary for the Department of Overseas Trade, expressed the main reasons for this to Runciman. It appeared to him that the remedy for German undercutting of prices had to lie in the hands of the various importing countries and it encouraged him to note that some of them realised the danger which they ran, both economically and politically, in concentrating so much in a single channel. For Britain, there remained the possibility of "doing a deal" with the nation with which Britain shared such a large proportion of the export trade of the world. But in the end, Wallace claimed, the practical arrangements would have to be concluded by the individual U.K. and German industries - with the consent of the German Government. In support of this view he pointed to the German officials who had been present at the discussions between representa-

tives of industries of both countries, such as the locomotive and textile machinery makers. Wallace thought this to be the only concrete suggestion and its practicability depended on overriding political considerations.<sup>31</sup>

Similarly, Waley thought that the only action which could usefully be taken to protect British exports from German competition was cartel arrangements. To his mind it was part of the wider problem, "of getting Germany out of her lunatic asylum into the fresh air". Leith-Ross foreshadowed the Cabinet Paper he was soon to submit (see p.184 below), by declaring that the only way to induce Germany to agree to a reasonable allocation of markets, for example coal or heavy engineering, would be by threatening to beat her at her own game. But this would involve British manufacturers in setting up a special fund and the Export Credits Guarantee Department adopting a more liberal line.<sup>32</sup>

At an inter-departmental meeting, held at the Board of Trade on 30 October 1936, it was thought desirable that the Department of Overseas Trade should give such encouragement as it could to British industrialists to enter into discussions with their opposite numbers in Germany. But it was also decided that any direct intervention by the British Government in Berlin was to be deprecated. Rather, a few manufacturers who were suffering from competition would be selected and encouraged in this respect. It was also reported from Berlin that the Germans were very ready to discuss the question of international trade with British manufacturers for the purpose of arriving at a mutually advantageous arrangement. But, it was pointed out, any decision would have to have the blessing of the German authorities.<sup>33</sup>

Thus, almost a year after the Ashton-Gwatkin memorandum was written, the direction of policy moved towards attempts to develop economic agreement with Germany, but at a non-governmental level. For the motive behind the policy had changed. Rather than hoping to achieve a rationalisation of markets as part of a general political settlement, it was thought that British export markets could be best protected by reaching agreement with German industry—the greatest threat to those markets.

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30. *ibid.* Appendix 2 of the survey: statistical comparison of U.K. and German export trade.

31. *ibid.* 22 Sept. 1936.

32. *ibid.* minutes, 23 & 26 Oct. 1936.

33. *ibid.*

Also at the end of the year, Leith-Ross produced a paper for the Cabinet on the problems with the British balance of payments. According to Peden it was from this time that Treasury officials began to talk of Britain's economic strength slipping away. They warned against the effects of the adverse balance of payments on the country's international purchasing power represented by its gold and foreign exchange reserves, overseas investments and ability to raise international credit. The idea of imposing exchange controls was repugnant to Whitehall: anything on the scale or of the character of those in Germany would have smacked of dictatorship and been seen as a serious blow to international trade.<sup>34</sup>

It has been claimed that Leith-Ross's paper was the first stage (the second being in March 1937) of an economic review which brought home to ministers the severity of the threat which rearmament posed to the British export trade. This was so because the effects of rearmament happened to be coupled with the contraction of export markets and the domestic orientation of Britain's recovery from depression. It seemed to those concerned that the country was in danger of losing, irretrievably, her position in world trade.<sup>35</sup>

The Cabinet paper concentrated on the question of British exports, and within this highlighted the most serious competition which exports had to face from Germany and Japan. There could be no doubt that Germany was absolutely, and relatively, worse off than in the pre-1931 period. In view of the differences in currency policies, Leith-Ross compared relative changes in the volume of exports, when price changes had been eliminated. The decline in the case of Germany in 1935 relative to 1929 was 46 per cent and in the U.K. 25 per cent. But 1929 was, apparently, a peak year for German exports. They had also expanded in 1936 at a rate of about 13 per cent as against one per cent for the U.K. Germany was, consequently, tending to improve her relative position; and German penetration of neutral markets was particularly noticeable.

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34. Peden, British Rearmament, pp.63 & 84.

35. Evers, 'Overseas Trade Policy', p.204. Evers states that as ministers were not well informed (the consideration given to the economic effects of rearmament was kept within the Treasury), it is very difficult to know what part this factor played in encouraging the Government to contemplate economic appeasement. Evers does not make plain what is meant here by 'economic appeasement'. And even if ministers were poorly informed about details, the overall economic situation was very clearly a factor in encouraging policy-makers to facilitate Anglo-German industrial discussion.



German success was due to subsidies, barter, and the higher prices she was prepared to pay for local products, provided 'Aski' marks were accepted. It was also partly due to the long and liberal credit facilities which had been granted; export organisations were also energetic and enterprising. By way of illustration, Leith-Ross produced some statistics of the geographical distribution of British and German exports, of which the following is an abstract.

£,000's (Average exchange rate)				
	U.K. exports in 1st½ Year.		German exports in 1st½ Year.	
	<u>1935</u>	<u>1936</u>	<u>1935</u>	<u>1936</u>
Europe	80,828	75,695	120,290	130,150
America, S. & C.	18,451	18,726	13,360	18,900
Total for all Areas	206,475	207,890	162,310	182,040

The improvement in Germany's relative position and the wide geographical distribution of Britain's exports is clearly evident.

Leith-Ross rejected the idea that the Government could or should promote U.K. trade through barter, clearing or even subsidy arrangements. Yet Germany had been successful in giving long-term credits which would, he thought, be regarded as risky by the more conservative financiers in Britain - the implication being that all financiers in Britain were conservative. As far as export credits were concerned it was clear that the U.K. (through its financial strength), should have been in a favourable position to compete with Germany. What was lacking, he continued, was the appropriate organisation and spirit of enterprise. British banks had never engaged in long-term contract financing as German banks had, and they did not have the same close connection with manufacturers.

Leith-Ross had no doubt that Germany's success was also largely attributable to the superiority of the Nazi export organisations. He reiterated that the promotion of industrial agreements with Germany and Japan would be a helpful line of approach. With the expected upward turn in the economy, he hoped it would be easier to negotiate working arrangements for a reasonable allocation of markets. The Iron and Steel cartel had shown the way. U.K. industries had to be urged to adopt this method as the solution of one of their most pressing problems, even though it had been just decided that it would be undesirable to make any official approach to the German Government to foster such arrangements.

Leith-Ross felt it to be unnecessary and disagreeable for the British Government to have to imitate all the expedients which Germany had adopted. But he

did think that Britain's heavy industries might be advised to set aside a definite proportion of their profits to an Export Fund. Moreover, the mere suggestion of the intention to create such a fund might have induced the Germans to come to an understanding for a reasonable sharing of markets.<sup>36</sup>

Fortunately, the relevant record of the FBI's Tariffs and Commercial Treaties Committee, which met on 15 December to consider this question, still survives. Glenday, the Economic Adviser, reported on a memorandum he had written. He believed the object of Germany's industrial system - which was in the nature of a single cartel unit - was to centralise control of her industries, to decide which markets she could develop and then concentrate on those markets. The remedy advocated by Glenday was, again, one of agreements between sections of industry in the two countries. Indeed, the Federation had already assisted industries to make contacts with their opposite numbers in Germany. Whether or not it was included in this category, the agreement between the German textile machinists and Sir Walter Preston was probably in the minds of those assembled. A minimum price had been fixed for each market, a maximum credit term of twelve months had to be quoted by both the U.K. and Germany, and Germany had to quote prices at parity with Britain in markets where she had clearing or compensation agreements. <sup>37</sup> The possibility of further duties being imposed by the IDAC had, Glenday declared, undoubtedly induced the Germans to seek agreements which would not otherwise have been reached.

One suggestion to counter German competition was that Britain should ensure, by means of trade and payments agreements, that sterling arising from U.K. purchases was spent either in buying U.K. goods or paying U.K. debts. The Committee took note of the wishes of the Government that the FBI should continue its policy of establishing contacts in Germany, and that official negotiations were not desired. But the Committee also heard that if the more acute forms of competition were removed, the respective Governments would give their goodwill and support. Members felt that it would be desirable if trade associations initiated negotiations.

It was also commented upon that, "Germany was the best industrially organised country with which to negotiate, having been cartel minded for about 50 years and always ready to enter into agreements of this nature". Furthermore, it was hoped that satisfactory agreements would not only bring British industry

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36. CAB 24/265, CP 339, 'The Balance of Payments', 7 Dec. 1936.

37. FO 20731 C87.

into contact with the very useful connections Germany had with other countries, but also that if British interests were associated with an agreement, it would increase the confidence of other industries in negotiations with German industry. There seems little doubt that the FBI wanted the Government to take some action but realised that that was hopeless in the circumstances. This was especially so in the case of the Payments Agreement. The complaint was that when the original concessions were made by Britain, no one had had any knowledge of the operation of the German export subsidy. This had resulted in hardship for a great number of smaller manufacturers.

It emerged from this meeting that, in contrast to Germany, it was difficult to organise negotiations when in any one industry in Britain there might be a number of competing interests and rivals. Nevertheless, it was agreed that Federation officials should first explore the position with industries willing to enter into negotiations and then proceed to Germany to explore the situation there and establish contacts for negotiations between industries concerned.<sup>38</sup>

The FBI were not to know, but one part of the governmental machine was not aware that such a policy was about to be initiated. Just before Christmas 1936, Laurence Collier was amazed to see the orders the Department of Overseas Trade had received from the Board of Trade concerning industrial co-operation with Germany. The Foreign Office now experienced a "minor explosion", as Kaiser has termed it.<sup>39</sup>

In a pique of inter-departmental rivalry, Collier declared that it was another instance of the way in which the Board of Trade tended to take important decisions affecting foreign policy without consulting the Foreign Office. Ashton-Gwatkin was not so concerned. He cited the most important international agreement - the continental steel cartel - in which the U.K. industry had taken its place a year earlier to its considerable advantage. The Government had used their tariff power to force an entry for the U.K. on a satisfactory basis. Ashton-Gwatkin thus maintained that agreements of this kind had nothing to do with "keeping Germany lean", if indeed that was the policy of the Government.

Collier returned to the attack as he felt that the Economic Section and the Northern Department notoriously held different views on the advisability of cartels in general and cartels with German firms in particular. He also

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38. FBI 200/1/1/78, minutes of meeting headed 'German Export Subsidies'.

39. D.E.Kaiser, Economic Diplomacy and the Origins of the Second World War (Princeton, N.J.1980),p.187.

criticised Leith-Ross's Cabinet Paper for its lack of reference to clearings as a possible defensive measure and for its tolerance towards the stabilisation of Germany's advantageous position. Collier did not think that industries should be advised to come to terms with Germany before any step of counter-action had been taken. The reductio ad absurdum of the piecemeal policy being pursued was for the Board of Trade to negotiate purchase agreements with countries (for example, Latvia and Lithuania for iron and steel), binding them to take a certain proportion of British goods, and then to encourage the firms concerned to enter into cartels which prevented the agreements from being carried out. Collier wanted no action to be taken before the Cabinet had considered the question. 40

Meanwhile, the FBI's suggested direct approach to Berlin was considered by the trade departments. Rather than active intervention, the more discreet process of the Commercial Counsellor J.H. Magowan liaising with the FBI's Berlin representative Jordan, was preferred.

It then emerged that the Foreign Office had indeed been represented at the inter-departmental meeting on 30 October by Gladwyn Jebb, but that he had failed to circulate the minutes to his colleagues. It seemed that some papers had also been lost. Jebb believed, however, that essentially the scheme approved by the inter-departmental committee was one for preventing both Germany and the U.K. from losing large sums of money unnecessarily. He thought the proposed instructions to the Commercial Counsellor innocuous; care had been taken for the Government to remain uninvolved. He concluded, somewhat prophetically, "But circumstances alter quickly and what is undesirable today may well be desirable tomorrow". Vansittart concurred and instructions were therefore despatched to Magowan on 15 and 30 January. 41

Magowan responded with caution. The necessity was to avoid presenting the Germans with an opportunity to make propaganda. He endorsed the suggestion that the question of agreements should be left to the individual branches of industry. In that way the Germans could be led through a number of technical agreements. Subtlety was the keynote of Magowan's recommendations. Yet he questioned the FBI's belief that, in their words, "a cordial relationship exists between the FBI and Reichsgruppe Industrie which has extended over a number of years". Magowan outlined the changes which had occurred in the preceding months and the tightening of political control. He thought it a good idea that the FBI representatives now proposed to visit Berlin as part of a general European tour on routine business, and simply to pay courtesy calls on the Reichsgruppe Industrie. 42

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40. FO 20731, minutes by Collier and Ashton-Gwatkin, 23-30 Dec. 1936.

Ramsden and Glenday duly visited Berlin on 10-12 March 1937. The meeting at the Embassy was attended by the Department of Overseas Trade representative Lyall. It was confirmed that selected groups of manufacturers should have direct discussions with their German opposite numbers but that there were dangers in attempting to use German official sources or major industrial organisations as the stepping off ground. There was reason to believe that German industry would welcome discussions. Thus, in order to avoid political interference as much as possible, it was decided that the Embassy would support the FBI in their endeavours to arrange discussions by industrial representatives. The Federation would contact Fachgruppe or Fachuntergruppen, securing guidance ~~where~~ necessary from the Wirtschaftsgruppen or Reichsgruppe Industrie.

Ashton-Gwatkin minuted that he had heard that the two FBI representatives were not happy with their visit to Berlin. They had complained that the "Moscow" atmosphere prevailed -officials and businessmen were afraid to talk, and political considerations stood in the way.<sup>43</sup> Indeed, this is borne out by the report of the visit that Ramsden and Glenday gave to the FBI committee. They considered that negotiations could be approached from above and from below. As far as the latter were concerned, machinery for agreement existed in the different industrial groups, and establishing contact would be left to Jordan. The approach from above had, nevertheless, to be considered. They had found that the German authorities desired to increase foreign exchange from exports rather than the volume of exports. But in dealing with the higher members of the German economic hierarchy Nazi Party members would be involved, and all kinds of embarrassing political questions were then raised.

Glenday was of the opinion that it was wiser to stress the efficiency of Germany's economic organisation than to seek to minimise it. It was the existence of the National Plan which determined that Britain had to deal with the Nazi Party leaders. In different parts of the world British industry was competing with the German Government. This was a new form of state trading. Industrial agreements might, then, be used by Germany not merely to secure better export prices, but to enable her to reinforce her subsidy and compensation policies

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41. *ibid.* Mullins (Overseas Trade) to Browett, 1 Jan. 1937 and C87/C245/C1454.

42. *ibid.* Memo and letter to Mullins, 15 Feb. 1937.

43. *ibid.* Mullins to Browett, 24 March 1937 and C2559, 15 April 1937.

in other directions. Glenday declared that he was not pessimistic - in coming to terms with the reality of the situation he probably thought he sounded so - but that there was need for caution. German 'bulk' purchases of raw materials, for example, tended to exclude British exports from third countries. The chairman of the meeting, Sir William Larke, felt that whatever the politics of the two countries might be, talks were desirable and were made easier by the friendly contacts existing.<sup>44</sup>

Thus, since the report on German competition it had taken several months to achieve very little in the way of industrial agreements with Germany. The President of the Board of Trade requested that the original report be updated so that the arguments for and against an alteration of the Government's attitude could be reviewed. But the moving spirit for the new report was Robert Hudson - who had replaced Wallace as Secretary for the Department of Overseas Trade. It was his opinion that, provided there was no insuperable political difficulties, the time has come when the Government could consider whether further substantial progress could be made by the two Governments jointly taking a more active and direct part.

Hudson believed that, as the German Government was in desperate need of foreign exchange, any measure which increased their resources would be welcomed. But, more significantly, both Governments might be influenced by the fact that industrial co-operation could have a favourable effect on political appeasement. The British Government did not want to subsidise exports, but something would have to be done to meet German subsidies otherwise Britain's export position would deteriorate. Hudson therefore favoured agreements; for even if trade did not increase, prices rose and British industry was strengthened. He also believed that the Dominions should not argue against cartels, for it was necessary for the mother country to be prosperous and consumer interests were not neglected. But, he also realised that political circumstances dictated that no direct contact could be made with the German Government.<sup>45</sup>

The new report referred to the small advance which had already been made, although it claimed that government departments could not be expected to know all the cases of agreements, as industrialists were secretive. An informal arrangement had been made in 1936 between locomotive manufacturers in the two countries. Similarly, a more formal one existed between cotton spinning machinery manufacturers. In the Continental Steel Cartel, or Entente Internationale de l'Acier (EIA), there were agreements concerning the reservation of home markets and allocations of quotas for world export trade and price fixing. However, discussions between the British and German coal industry had been going on for over two years. Britain was trying to recover its 1913 share of



the market, while the Germans refused to give up any of the large increases in export trade which they had made in the previous few years at Britain's expense.

The report repeated that there was much to be said in favour of encouraging agreements. This time, however, the Foreign Office view was cited in full: there was no objection of principle to government-sponsored negotiations, but great care was needed from the political point of view. Negotiations would have to be on a private and non-official basis. The Foreign Office considered this to be a sound policy tending to improve relations between the two countries. It served to meet German complaints about trade restrictions and obviated the bad impression caused by imposing duties on German goods.<sup>46</sup>

There matters stood for several months until Hudson took the initiative once more. After a tour of industrial districts, he came to the conclusion that a good many British industries needed to amalgamate - be made to amalgamate if necessary - and that these amalgamated industries ought then to proceed to negotiate agreements with German industries on as wide a basis as possible. The Board of Trade was less enthusiastic but thought a meeting would be useful to see, yet again, what progress had been made since 1936.

This meeting took place at the Board of Trade on 7 December 1937. Mullins pointed out that as much as possible had already been done, but some industries were still negotiating. He stated, "This particular technique of industrial agreements has not been used in dealing with any other foreign country besides Germany, though there are, of course, a large number of cartels of different kinds operating with different countries." Nevertheless, Hudson continued to suggest that the Government should play a more active role in negotiations.<sup>47</sup> And, in this respect, he was himself most active in 1938 and 1939.

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44. FBI 200/F/1/1/78, Report, 23 March 1937.

45. T 160 729 12829/4, Memo. 9 March 1937.

46. *ibid.*

47. FO 20731 C8263, Minutes by Ashton-Gwatkin, 2 & 7 Dec. 1937.



## CHAPTER VIII

### British Policy from the Anschluss to the Outbreak of War.

Many of the important developments in Britain's external economic relations in 1938 and 1939, such as the Anglo-American Trade Agreement and the response of the British Government to German economic penetration in S.E. Europe, figure prominently in the historiography of the origins of the Second World War. The focus of this chapter is, however, on the points of direct contact between Britain and Germany in the financial and economic sphere. As general conflict in Europe came ever nearer, with German annexations of Austria and Czechoslovakia, the assumptions on which British policy towards Germany were based were questioned more closely. At the same time, policy-makers looked more than ever to economic and financial relations to provide a basis on which to reach a general political agreement with Germany. One explanation for this posture is that relations between the two countries were held to be better in the economic sphere than in any other. From 1931, agreements had been concluded, revised and had continued to operate successfully. It is in the light of these considerations that this chapter seeks to interpret the negotiations to revise the Payments Agreement, the negotiations between the Federation of British Industries and the Reichsgruppe Industrie, and the final clandestine contacts between representatives of the two Governments in the summer of 1939.

At the beginning of 1938 the democracies were able to entertain a small degree of optimism concerning the international political situation. This was provided by the negotiations for an Anglo-American Trade Agreement, which was eventually signed on 17 November 1938. This agreement has been called the outstanding success of the policy of the American Secretary of State, Cordell Hull. His plan was to preserve world peace by economic appeasement or disarmament. Nations like Britain and America would band together on economic grounds and show recalcitrant nations like Italy and Germany the undoubted benefits of joining in the same movement. In a visit to Washington in January 1937, the President of the Board of Trade, Walter Runciman, agreed in principle to a more liberal trade policy but emphasised the difficulties Britain would have in extricating herself from Empire preferences. Nevertheless, on 18 November 1937 the State Department gave notice that an agreement was in sight. A reduction in tariffs and discrimination, however small, between the two largest trading nations was of great significance, especially as they were competitors on the level of manufactures and because Britain discriminated against American agricultural produce.<sup>1</sup>

Hull believed that the reaction in Berlin to the news was one of keen interest as German officials evaluated what effect the agreement would have in stimulating a flow of American raw materials to Britain in time of war. Thus to Hull, the political effects (a reduction in tension) weighed as heavily around the world as the economic.<sup>2</sup>

This was also Chamberlain's hope. The reason why he had been prepared to go a long way to get the treaty was because he reckoned that it would help to educate American opinion to act more and more with Britain and because he felt sure that it would frighten the "totalitarians". He wrote, "Coming at this moment it looks like an answer to the Berlin, Rome, Tokyo axis and will have a very steadying effect".<sup>3</sup> It was the very international disturbances that prompted Hull to look to Britain which were to lead to Whitehall's search for an accord with Germany.<sup>4</sup>

The constraints which had shaped British foreign economic policy and the challenges which that policy had had to face since 1931 are well illustrated by two memoranda composed shortly before the Anschluss. Leith-Ross indicated how protection in 1932 had been so successful that German exports to Britain had been reduced by one half. German exports to the Dominions were also only slowly recovering as increased preferences in favour of U.K. goods had correspondingly diminished the possibilities of German export trade. As a consequence, German imports of raw materials from the Dominions had fallen catastrophically from £1,432 million in 1929 to £368 million in 1937. Thus to meet the deficiency, Germany had deliberately turned to European and near eastern countries for supplies, the latter having lost their former free entry into the U.K. This in turn affected British export opportunities to those countries. In Leith-Ross's opinion, German buying in Europe was in fact the counterpart to Ottawa and protection, and it seemed to have the same result in strengthening political as well as trade relations. The conclusion drawn was that Britain had been successful in passing on a part of her difficulties to countries like Germany, but that in time that

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1. Arndt, Economic Lessons, p.82.

2. C. Hull, The Memoirs of Cordell Hull (1948), p.530.

3. NC 18/1/1029, letter to Hilda, 21 Nov. 1937.

4. See R.N. Kottman, Reciprocity and the North Atlantic Triangle, 1932-1938 (New York, 1968); also T.K. McCulloch, 'Anglo-American Economic Diplomacy and the European Crisis 1935-39' (unpublished D.Phil. thesis, Oxford University, 1979).

reacted on Britain. As each country attempted to take measures to alleviate its own difficulties, it viewed measures taken by other countries as inspired by deliberate ill will. Therefore, while Britain could not afford to revise her policy drastically, any modifications which tended to increase trade with Europe could be expected to yield political and economic benefits.<sup>5</sup>

The strong sense of regret for the effect of British policy on Germany expressed by Leith-Ross is similar to that revealed by his Treasury colleagues in 1934. (See p.112). In the Foreign Office Ashton-Gwatkin developed the theme but attempted to exonerate his department from blame. Britain had locked "the last door in Germany's face" when protection came on top of depreciation. In response to German protests Britain had replied that negotiations would hardly achieve any useful purpose. The eventual tariff was, of course, not as hard as the emergency duties, and the 1933 agreement had provided some relief for German trade.

Ashton-Gwatkin crystallised economic policy with the formula, "Home industries and agriculture first; Dominions second; foreigners last". It was this policy which had killed the system of international trade. In November 1931 the Foreign Office had recommended that before tariff policy was definitely decided, it should be brought into relation with general foreign policy, with special reference to appeasement and security in Europe. This argument had been dismissed or disregarded. Ashton-Gwatkin therefore felt that there was no contribution Britain could make to economic appeasement. He thought that it was remarkable that the doors could be opened as wide as they were being to the United States. The future seemed to be developing along the lines of large preferential groups or Grossraumwirtschaft. If that was so, it was a consolation that the U.K./U.S.A. was the richest group and its future economic, even political, influence would be the decisive factor in the twentieth century. This, Ashton-Gwatkin believed, was the logical development of the choice made in 1931-2.<sup>6</sup>

But by the middle of 1938 the Government was becoming increasingly concerned at how British influence was being challenged by the growing German domination of S.E. Europe. Ashton-Gwatkin advocated renunciation of Britain's Most Favoured Nation treaties in the region. The Cabinet approved the Foreign Secretary's plan to set up an inter-departmental committee to co-ordinate all aspects of policy with a view to securing that maximum political advantage was extracted from the economic weapon. The scheme which was evolved, to counter German penetration by governmental intervention in the free market, represented a radical departure in British policy and opened up old political divisions in the Cabinet and in Whitehall.<sup>7</sup> However, from September 1938,

Chamberlain sought to bring British policy towards S.E. Europe into line with his efforts to reach a settlement with Germany. He took with him to Munich a proposal, prepared by Leith-Ross, for Anglo-German co-operation in the Balkans. Hitler declined to discuss it.<sup>8</sup>

But pressure began to mount on the Government to meet the German challenge. The business community in Britain was worried at the state of the export industry. In particular, uneconomic German trade policies were held to be partially responsible for Britain's balance of payments deficit. The Association of British Chambers of Commerce held a conference in October to discuss the need for greater firmness in trade negotiations, measures to oppose export subsidies and a modification of the MFN clause.<sup>9</sup>

Official policy towards S.E. Europe therefore attempted to run in two directions from the autumn of 1938. For while the Government decided to purchase Romanian wheat and thereby place sterling at the disposal of the Romanian Government, a Cabinet Paper written by Halifax declared that, "We must be ready to permit Germany to obtain all she materially requires in these areas - indeed, we cannot very well prevent her from doing so".<sup>10</sup>

More than this, Britain had to consider an "alternative policy" of assisting Germany in developing the countries of the region, by financial support if required and especially in the form of providing raw materials on credit. Halifax did not think that there was anything revolutionary in this concept: the economic alliance between Germany and the Austro-Hungarian Empire had been as close as the political alliance and short-term money regularly supplied by London had played an important part in the trade. A possibility existed, therefore, that a renewal of this system would help to promote British economic influence both with Germany and S.E. Europe. Such a policy might have resulted in a proportional increase in exports from Germany much greater than from the U.K. It would thereby mean the abandonment of a policy which Germany would interpret as deliberately obstructive to her, namely the granting of credits on a non-commercial basis or direct Government purchases which would divert trade to the U.K.<sup>11</sup>

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5. FO 21701 C1828, Note, 25 Feb. 1938, by FLR for Van Zeeland Committee.

6. *ibid.* Private note to FLR, 10 March 1938.

7. CAB 24/277, CP 127, 24 May 1938; Einzig, Appeasement, p. 91. Middlesmass, Diplomacy of Illusion, p. 258.

8. M.J. Rooke, 'The British Government's relations with the states of South Eastern Europe, 1934-36' (unpublished Ph.D. thesis, University of London, 1980), p. 201.

9. G.J. Van Kessel, 'The British reaction to German economic penetration in South Eastern Europe, 1936-1939' (unpublished Ph.D. thesis, University of London, 1982) p. 172. British Export Gazette, Vol. XXXI, No. 371, Nov. 1938; British Trade Journal and Export World, Vol. LXXVI, No. 910, Dec. 1938; The Times, 17-19 Nov. 1938, report on 'German Trade Aims'.

Leith-Ross and Ashton-Gwatkin pursued this alternative policy in their meetings with German officials between October 1938 and February 1939. Schemes were put forward in which Germany would be offered more free exchange in order to pay for additional imports from S.E. Europe. It was hoped that the latter would then increase their purchases from the British Empire.<sup>12</sup> There was yet a further dimension to the background to Anglo-German economic relations in the months before the outbreak of war. The Treasury also considered how capital might be provided for S.E. Europe. Furthermore, it was pointed out that, from the purely economic standpoint, a loan of even a "couple of hundred million pounds" which would bring Germany back into the international camp would be both cheaper and a better investment than Britain's armament expenditure.<sup>13</sup>

#### i) The Crisis over Austrian Debts after the Anschluss

By 1938 Britain remained the only country where Germany negotiated directly with her creditors. In all other countries the German Government negotiated with the government of the creditor country. But just as this distinction appeared to be somewhat unreal in the case of the negotiations which led to the Payments Agreement in 1934, so it also seemed to be in 1938 when, after the Anschluss, the British Government came close to substituting a clearing system (in which U.K. creditors of Germany would be paid from the payments made by U.K. importers of German goods), for the Payments Agreement. In order to secure satisfaction over payment of Austrian debts, the British Government was prepared to sweep away the foundation stone on which economic relations between Britain and Nazi Germany had been built.

Indeed, the Payments Agreement had come to be regarded with special favour by officials in London. In the Bank of England Cobbold noted that the entire responsibility for the working of the agreement had been placed on the Reichsbank, and that the very efficient German systems of trade and foreign exchange control were responsible for the very satisfactory results which had been obtained. Cobbold praised the agreement as a model of lucidity and simplicity.<sup>14</sup>

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10. CAB 24/280, CP 257, 10 Nov. 1938.

11. *ibid.*

12. Kaiser, *Economic Diplomacy*, p.286.

13. T 160 866 15447/021/1, unsigned and undated minute.

14. BE OV34/204, 21 April 1937.

At the end of 1937 Ashton-Gwatkin also expressed his satisfaction that the agreement had led to goodwill and mutual understanding. Germany had paid the heavy commercial debts with remarkable speed. The operation of the agreement was so satisfactory that although originally it was expected to run only for a year, it had by mutual consent been left to run on without modification for three years. Ashton-Gwatkin thought that the Germans wanted other agreements along the lines of the British model.<sup>15</sup>

However, Magowan, at the British Embassy in Berlin, began to challenge the assumptions which underlay the Payments Agreement. There was, he felt, a strong indication that the necessities of Germany's state directed economy had been pressing hard against the general 1932-3 scheme of trade, the freezing of which had been one of Britain's objectives. In 1936 Germany had devoted not the due 55 per cent of her exports to the U.K. to purchases from the U.K., but 65 per cent and in 1937 71 per cent. Scrap metals were one of the chief commodities which accounted for this spectacular rise.<sup>16</sup>

In the Bank of England Sir Otto Niemeyer contemplated a scheme for an 'all-in' financial settlement with Germany. Niemeyer, an Adviser to the Governors, was made a Director in 1938 and he was also a member of the Council of Foreign Bondholders of Germany. He examined the problem of Britain struggling over long-term market debt, Standstill debts, and advances to BIS in respect of Germany which largely formed the cover for BIS long-term debts due to Reparations creditors in France and Germany itself. Niemeyer considered that while the Payments Agreement (and behind it the threat of a clearing) protected at least the interest of the long-term market and Standstill debts, nothing effectively protected the BIS debts.<sup>17</sup>

The Lever Committee for British Long and Medium-term Creditors of Germany made an informal proposal to the German authorities that in return for a reduction in interest rates from 7 to 5.5 per cent on the Dawes Loan and from 5.5. to 4 per cent on the Young Loan, a sinking fund should be set up at a rate of 1.5 per cent. The Germans, however, wanted no sinking fund for three years, the significance of which was not questioned from the political point of view.<sup>18</sup>

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15. T 160 743 13999, Letter to H.M. Legation, The Hague, 4 Dec. 1937.

16. BE OV34/205, 23 Feb. 1938.

17. BE OV9/100, 17 Jan. 1938.

18. FO 21644, C4592, Memo. by SDW, 12 May 1938.



But in March 1938 the Anschluss threatened the existence of the Payments Agreement. Germany secured gold and reserves of the Austrian National Bank which British officials estimated to be up to £20 million, with £80 million in realisable foreign securities. But no undertaking was given to honour the service of the Loans for the Reconstruction of Austria - the Guaranteed 4.5 per cent Conversion Loan of 1934, the Guaranteed 3 per cent Loan of 1933 and the 7 per cent Loan of 1930. These loans were issued under the auspices of the League of Nations and, as one of the international guarantors the British Government was liable to pay £675,000 per year in case of total default. Leith-Ross immediately recognised that because of the Anschluss, negotiations would be both more urgent and difficult and that Britain would have to threaten a clearing. He suggested to the Board of Trade that they should drop the hint to British exporters to restrict commercial credit.<sup>19</sup>

An inter-departmental meeting was convened at the Treasury in April to consider the problem. Leith-Ross was anxious that if Germany offered anything less than unconditional full payment, negotiations should be started by the international Control Committee for the loans. At the same time, Leith-Ross was prepared to make an approach to the German Government for a bilateral agreement with the U.K., in case the international negotiations failed, as part of the main negotiations for the revision of the Payments Agreement to include Austria.

During the years 1935-7 there had been a rough balance in trade between Austria and the U.K. If this trade were to be maintained, the per-centage of exchange to be allocated to U.K. exports under the Payments Agreement would need to be increased from 55 per cent. It was hoped that Germany would agree to the figure of 60 per cent for Greater Germany, which was, anyway, nearer to the per-centage of exchange actually applied by Germany to purchases in the U.K. Nevertheless, a strenuous resistance was anticipated, especially when demands for increased payments in respect of debts were also made. The revision of the Payments Agreement therefore provided an opportunity to settle the question of Austrian debts and the Dawes and Young Loans' interest rates.

The Treasury meeting showed that there was still no doubt that a unilateral clearing would cause a serious dislocation of trade, and that British banks might determine to drop out of the Standstill if it were endangered. It was held that while such a clearing would harm Britain a good deal, it would do still greater harm to Germany. Although it was hoped that reasonable concessions might produce a settlement, the officials hardened themselves against the negative considerations in the knowledge that where the Germans had economic power, they had not hesitated to use it ruthlessly.<sup>20</sup>



A statement of British desiderata was then submitted to the Chancellor of the Exchequer. Export trade in U.K. goods to Germany and Austria since 1934 had amounted to 70 per cent of the export trade of Germany and Austria to the U.K. The exchange allocation under the Payments Agreement would thus have to be increased to 65 per cent. The Chancellor was reminded that many argued that there was no real reason why Britain should be so benevolent as to allow Germany a considerable element of free exchange at all. But the officials felt that this was the reason why the Agreement worked so smoothly and that the U.K. was likely to gain more from such a revision of the Agreement than from any clearing. It was calculated that a 65 per cent allocation would still leave Germany with an annual free surplus of £3.5 million and,

"any free sterling that she can retain is of the greatest value to Germany, for the purchase of raw materials of which she is in such great need". But in discussing the political aspects of the problem, it was not asked why Germany had such great need for raw materials.<sup>21</sup>

However, it was still the case that Germany was without recompense for her trade surplus to the extent that the balance of sterling earnings accruing to her simply wiped out debt. The Bank of England was concerned that terms for revision should not be pressed too harshly in case Germany reneged on all her existing arrangements for servicing British financial claims. It was in this sense that Montagu Norman advised the Treasury that a sufficiently low per-centage figure should be set in order to leave a margin for claims. Indeed, Leith-Ross was prepared to accept a figure of 60 per cent in order to avoid precipitating a rupture.<sup>22</sup>

The Chancellor in turn informed the Prime Minister that the views of the City authorities would have to be considered before a final decision was taken on the figure.<sup>23</sup> At a meeting at the Prime Minister's room at the House of Commons the next day, it emerged that payments on Austria's external debt due 1 April had been made, but that this was the result of instructions given before the Anschluss which Germany had not revoked. It was agreed that a 70 per cent allocation would be justified on trade grounds and that part of the exchange used to pay off the trade arrears could help to make up the figure. Leith-Ross argued against any credit being granted for

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19. FO 21641 C1966, 17 March 1938.

20. T 188 214, 4 April 1938.

21. BE OV34/205, 6 April 1938.

22. BE OV6/290, Gunston to SDW, 6 April 1938; OV34/205, note, 7 April 1938.

23. T 188 214, 11 April 1938.

the purchase of British raw materials such as yarns and non-ferrous metals. Rather, Britain would have to aim at increasing her share of manufactured goods. Sir Frederick also pointed out that it was not so much a clearing which Germany would resent (she had such agreements with about 42 countries by 1938), but a clearing imposed without agreement.

It was thought that the German authorities would certainly refuse to pay the full service on the 1930 7 per cent Loan; if they did they would be left without an argument against providing a sinking fund for the Dawes Loan, which they had refused to do on the grounds that the rate of interest, 7 per cent, was too high. It was decided to demand a sinking fund, but it was deemed to be inadvisable to threaten immediately a clearing to secure full service of the Austrian loans. The Treasury began to consider how to revise the clearing initialled at the same time as the 1934 Payments Agreement.<sup>24</sup>

Leith-Ross travelled to Berlin to start negotiations with Dr. Brinkmann (from the German Economics Ministry) in the last week of May 1938. As soon as he arrived, Leith-Ross was instructed by the Board of Trade that a figure of 65 per cent for British exports would not be high enough. Brinkmann accepted in principle a figure of 70 per cent in a revised Payments Agreement, but he refused to accept responsibility for the Austrian Loans. Leith-Ross straight away sought permission from London to announce the intention to denounce the Payments Agreement. A meeting was called to consider the request. The Board of Trade, having secured their objective of 70 per cent, were entirely against denunciation, while the Foreign Office had no objection to denunciation at any time. Gunston, from the Bank of England, felt that it would be better to denounce the agreement only after 1 June when it would be known whether the Austrian loans were in default (it would be July before there could be any default to bondholders). Conversations could then be opened about a clearing, which would place pressure on the Germans.<sup>25</sup>

It seems that this advice was accepted. For Leith-Ross was disappointed with his instructions not to denounce the agreement before 1 June, even though he was allowed to threaten denunciation. When Sir John Simon (Chancellor) wrote to Viscount Halifax (Foreign Secretary) to say that Leith-Ross should not be overruled, the latter was given a free hand on the last day of May, much to the delight of the Foreign Office.<sup>26</sup> When the German Government then claimed that they had no legal authority to pay the interest instalments, Leith-Ross gave notice to terminate the Payment Agreement. In London the Cabinet contemplated how such a "steam-hammer" of a

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24. T 188 214.

25. BE 0V34/205, note, 27 May 1938.

weapon had come to be used by Leith-Ross, who had taken special account of German psychology. In the middle of discussions news arrived of the German response: interest on the Austrian loans would be paid in full if the British Governemnt could persuade the bondholders to accept a reduction in interest rates. The German representatives did not want the agreement to be terminated, but they were ready to agree that if a settlement had not been reached by the end of June, Britain would be free to terminate it, and the need for one month's notice would be waived. Chamberlain declared that, "this confirmed previous experience of the need of a great firmness in negotiations with Germany". The Cabinet accepted this Gentlemen's Agreement concerning termination.<sup>27</sup>

The Treasury decided on the action to take over the default on the Austrian debts. Pinsent in the Berlin Embassy was asked to make known the deplorable impression which had been made. The Chancellor would announce the Payments Agreement was coming to an end, while the Trustees of the loans would make a protest and a public announcement. As for a clearing, preparations were already well advanced. Staff were being ear-marked for the Clearing Office by its head, Gregory. Leith-Ross revealed an approach to the problem which perhaps owed much to his frequent dealings with the Nazis. He suggested that Gregory should engage a German linguist and send him to Germany to get some experience of German clearing methods in order to bring home to officials there the seriousness of Britain's intentions.<sup>28</sup>

Indeed, the nazification of the German financial authorities so alarmed Leith-Ross that he circulated a note about the revolution in the administration. Old civil servants had been swept away (the Party controlled the Reichswirtschaftsministerium), and Germany was governed according to the more or less arbitrary decisions of a few men; no one else was willing to take responsibility. In the circumstances of the myth that Austria had never been a national or economic entity, it had become a matter of principle with the Nazi Party to secure the writing off of loans made by Britain and France. Leith-Ross noted that German banking circles thought that Austrian debts should be paid, as did Schacht who was therefore probably relieved that he did not have to conduct the negotiations. In fact, Schacht had explained to Leith-Ross that, except for the Standstill, the Reichsbank would not participate in the negotiations. Schacht had been very sorry to see Jewish colleagues having to leave the Bank, such as Otto Jeidels, and he described Germany's financial policy as a compound of the recipes of Lenin and Keynes.

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26. FO 21644 C5223, minute, 27 May 1938.

27. CAB 23/93, 27(38).

28. BE OV/290, 3 June 1938.

(which, in view of the dirigiste type of policy which Keynes was to advocate for post-war Britain, was not inaccurate). Schacht claimed that he had only helped to run the system because he was a German patriot.<sup>29</sup>

Having pressed for denunciation Leith-Ross became worried that it would be of doubtful expediency. The Board of Trade and certain City circles had, of course, agreed to denunciation with great reluctance. And the British Ambassador thought that it would greatly increase the political tension. Henderson suggested to the Foreign Office that a German representative should be invited to London as a last chance to try to achieve a settlement without abandonment of principle on either side. Henderson did not think that the Germans would yield on the latter point. Similarly Pinsent reported that every opportunity had to be given to the Nazis before Britain slammed the door.<sup>30</sup>

But in Britain, the Association of Chambers of Commerce believed that the time had come to make a firm stand. Although creditors might thereby be involved in some loss, investment capital had already been lost: the Young Loan was quoted at less than £40 per £100, Konversionskasse bonds were the same and other obligations were quoted at £25. The Council was not only prepared for a clearing, it actually urged the Government to set one up if there was no settlement; members would endure sacrifice in order to see fair play for British investment abroad.<sup>31</sup>

According to Nigel Law the City was also unanimously in favour of introducing a clearing if necessary and was reluctant to allow Germany to use the familiar method of depressing the price of stock and then repatriating the few remaining on which payment was made. Law wrote, "Moreover there is a growing feeling here that on general political grounds it has always proved fatal to make any concession whatever to Germany". The Foreign Office had, of course felt just that for a long time. There also seemed to be less concern in the City that Germany would switch trade away from the Empire; it was thought that she had already found as many alternative sources of raw materials as possible. <sup>32</sup>

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29. T 188 215, 29 May 1938.

30. *ibid.* Telegram, 10 June 1938. T 160 769 15447/09, 16 June 1938.

31. BE OV/206, letter to Sir John Simon, 1 June 1938.

32. FO 21645 C6067, letter to Sargent, 17 June 1938.

Those in the City who were most concerned that the existing financial arrangements between the two countries should not break down included the Standstill creditors. In circumstances very similar to those of 1934, Lord Wardington, (of Lloyds Bank and now Chairman of the Joint Committee), wrote to the Bank of England to warn that if negotiations between Britain and Germany broke down, so also might the Standstill. In this case, all relevant bills would have to be taken off the market, some £22 million in total. The German economy would be deprived by that amount of the cheapest money that it enjoyed: the interest claims on the resultant cash advances would be considerably higher than the commission and discount charges on the corresponding bills. In repeating how the bankers believed the Standstill to be in a special position, Lord Wardington indicated that if its service were interrupted or affected, the bankers would look to the Government to give them the protection to which they felt themselves to be entitled. Catterns, the Deputy Governor, endorsed this letter and recommended to the Chancellor that in any clearing the proceeds of goods financed by a Standstill bill should be exempted.<sup>33</sup> All references to the Standstill were therefore left out of the Treasury Order for a clearing which was first drafted at this time. Cobbold passed on the information to Tiarks and told him that if the bankers asked for protection the Government would give the Standstill the same priority as Reich Loans.<sup>34</sup>

The Committee of Guarantor States of the Loans for the Reconstruction of Austria assembled in London in early June. The Italian Government had withdrawn from this League of Nations body and Leith-Ross had replaced Bianchini as its president. On 13 June a reply was received to the Committee's letter of protest. Leith-Ross wondered whether he had been misled by Brinkmann but he chose to believe that the reply was a step in the bargaining; it represented an advance in that the German authorities did offer some payment on the loans but in return for the British Government helping to increase German exports to the U.K. and the colonies. The recommendation given to the Chancellor was that there should be no hesitation in applying a unilateral clearing.<sup>35</sup>

The next day the Chancellor announced to the House of Commons that the Payments Agreement would come to an end on 1 July. The German Economics Minister Funk appeared to give a reply in a speech which was optimistic about the possibility of compromise which would not involve the Reich in abandoning the principle of non-recognition of the Austrian loans.<sup>36</sup> The

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33. BE OV6/291, 15 June 1938.

34. BE OV34/202, note, 16 June 1938.

35. T 188 215, minute, FLR to Chancellor, 13 June 1938.

36. The Times, 17 June 1938.

letter of rejection of the German terms by the Control Committee was handed to Dr. Bielfeld at the German Embassy. The latter attempted to justify his country's position by claiming that the Nazi Party did not want to have to recognise Austria's other obligations such as the concordat with the Vatican. Leith-Ross considered this a very poor argument as the succession to financial liabilities did not necessarily involve acceptance without modification of political treaty obligations.<sup>37</sup>

The German authorities wanted Leith-Ross to return to Berlin. But the consensus in London was that the German Government should send a representative to Britain. Dr. Wiehl thus arrived on 22 June. But some confusion was caused at this point when the Board of Trade appeared to want to go back on the agreed policy of allowing financial claims as the first charge on the clearing. It was feared that Germany might interpret such changes as **hesitations** about carrying through a clearing. Leith-Ross wrote to Sir William Brown to argue that financial claims had to be put before trade. Although there was a chance that a unilateral clearing might produce a very serious interregnum, involving restrictions on British exports, Leith-Ross was able to call on the support of the Chambers of Commerce, Fisher at the Treasury and the widely representative Board of the Midland Bank. Leith-Ross insisted that Britain had to use its power without hesitation as it was the only treatment which the German understood.<sup>38</sup>

But when the Chancellor and the President of the Board of Trade met, they could not resolve their differences. The former agreed that traders were just as important as creditors but thought that from a psychological point of view the only method of punishing the Germans was to collect the money in order to pay the debts which they wished to repudiate. But the Chancellor had to agree to postponement of the issue of the Clearing Order until some compromise could be reached with the Board of Trade. Instead, the possibility of a reserve fund and a further order deciding on priority was brought forward.<sup>39</sup> Leith-Ross made it clear to the Foreign Office that he would welcome their support in the firm line which he was adopting, more especially since he felt he was being assailed by what he called "defeatist" arguments by the Board of Trade. Vansittart hoped that the Foreign Office would indeed help to defeat the defeatist Board of Trade.<sup>40</sup>

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37. T 188 215, minute FLR to Hopkins, 16 June 1938.

38. T 160 769 15447/010, 21 June 1938.

39. *ibid.* FLR to SDW, 24 June 1938.

40. FO 21646 C6237, minutes, 24-25 June 1938.



Anglo-German negotiations covered the whole range of financial obligations with the exception of the Standstill. Dr. Wiehl offered to pay on the Austrian loans if rates on the Dawes and Young Loans were reduced to 4.5 and 3.5 per cent respectively and if the sinking fund were suspended for two years. Lever stood firm on 5.5 and 4.5 per cent with a sinking fund to commence at once. The Germans also desired reductions of rates on all other loans and concessions on trade. Leith-Ross offered to reduce the trade allocation under the Payments Agreement from 70 to 65 per cent and to make provision for the German Government to ask for further reductions if this did not allow sufficient free exchange to meet the total financial payments.<sup>41</sup> There was a further proposal put forward that the Bank of England should advance the sums necessary to make the payments on the Austrian loans. But the Bank told the Treasury that they did not like the idea of an advance at all, even for a short period: it might have been interpreted politically and made difficulties for the Government and the Bank.<sup>42</sup>

By 25 June little progress had been made with the negotiations and it was still not clear whether the Treasury would issue the Clearing Order: the Board of Trade continued to object strongly to creditors receiving priority over traders. Wiehl maintained that Germany could not undertake new obligations without being assured of additional exports to the U.K. and colonies and that Austrian assets were not available to meet Austrian debts.<sup>43</sup> Sir Alexander Cadogan (who replaced Vansittart as Permanent Under-Secretary at the Foreign Office in 1938), advised bearing in mind, "the advantage from the politico-military point of view which we would derive from the imposition of a clearing by restricting in this manner German purchases of essential raw materials". Unless it could be shown that the prejudice to British trade was going to be so serious that no other consideration could be put in the balance against it, a clearing should be imposed, Cadogan argued.<sup>44</sup>

But agreement was reached on 1 July between the British Government, the Lever Committee and the German Government. It gave to Britain most of what was desired. There was to be a full transfer on the Austrian loans. But the rates on the Dawes and Austrian 7 per cent loans were reduced to 5 per cent with a 2 per cent cumulative sinking fund. Rates on the Young and Saarbrücken Loans were reduced to 4.5 per cent with a 1 per cent cumulative sinking fund beginning after two years. As regards trade, a sliding scale was created for U.K. exports to the Greater Reich which should have allowed them to be maintained as before. It was agreed that a large proportion of these exports were to be finished goods. And, as Leith-Ross had suggested, it was to be open to Germany to ask for a reduction in the U.K.'s trade allocation if necessary.



The sliding scale for U.K. exports took the value of German exports to Britain in a normal year to be £30 million. Germany would import 60 per cent of this figure, or £18 million worth of U.K. exports. For every £x of goods which Germany exported above £30 million she would import an additional 90 per cent of £x over the £18 million. The scale would operate in reverse if Germany exported less than £30 million. Thus if Germany exported to Britain goods worth £35 million (as in 1937) she would have to import goods worth £22 million (or 64 per cent). If exports amounted to only £20 million imports would total £9 million (or 45 per cent).<sup>45</sup> The Bank of England calculated that Germany would be paying £1 million more per year to Britain under the new agreement. But as the amount would decrease by £100,000 in two years because of amortisation, and as Germany had £3 million left free after paying off the trade arrears, it was hoped that there would be a margin in the future for an increase in the service of non-Reich commitments.<sup>46</sup>

Einzig maintained that the British Government resorted to ruses uncharacteristic of diplomatic circles in order to secure agreement. It is claimed that the Germans were only induced to resume negotiations in London when forms, printed for the Clearing Office, were left conspicuously on Magowan's desk as he received a German official in the British Embassy. When the resumed negotiations still failed to go smoothly, the British Clearing official (presumably Gregory), visited the German delegation and passed in his card.<sup>47</sup> Bearing in mind the tactics suggested by Leith-Ross, these claims seem credible.

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41. BE OV6/291, FLR to Phillips, 22 June 1938.

42. BE OV34/206, note by Cobbold, 23 June 1938.

43. *ibid.* note by Gunston, 25 June 1938.

44. FO 21645 C5787, Cadogan to FLR, 24 June 1938.

45. Anglo-German Payments (Amendment) Agreement, Cmd.5787 & 5881, 1 July 1938. BE OV6/291, Memo. by Gunton.

46. BE OV34/206, Gunston to SDW, 6 July 1938.

47. Einzig, Appeasement, p.80.

The Bank of England felt that the complicated formula negotiated had saved German face and that it was evident that the weapon of a unilateral clearing which had been threatened until the very last day, was one of which the Germans were very much afraid. The Board of Trade was also very satisfied. In their view nothing had been given away and the result was considerably more satisfactory than they had had reason to expect. But the agreement did not escape criticism. It was noted that it involved an all round reduction in interest rates and the subjection of the claims of all Austrian creditors to the crippling exchange regulations which applied to all German debts.<sup>48</sup>

ii) The Federation of British Industries - Reichsgruppe Industrie Negotiations and the Reaction to Magowan's Memorandum.

The outcome of the financial negotiations was taken by Whitehall as a victory, not just for British policy, but also for the moderate Nazis who were supposed to have influence, if limited, on German policy. Signing the agreement would be an encouragement to the "Peace Party", just as the Czechoslovak May crisis had been a check to the "warmonger party". Ashton-Gwatkin regarded the Payments Agreement as the Ark of Salvation to the German moderates; it stood for what was left of Germany's aspirations for international trade. It was the spiralling process of the extension of trade bringing with it the extension of further credits to Germany and hence further trade, which was regarded as a practical step towards economic appeasement. There was little scope for reduction in British tariff, but possibilities existed for reaching marketing agreements with Germany.<sup>49</sup>

Robert Hudson also saw an opportunity arising from the revising of the Payments Agreement. He had already encouraged contacts between British and German industry in 1937, with a view to bringing about marketing agreements. Following the inter-departmental meeting of December 1937 (see previous chapter), a further meeting was arranged for 1 February 1938. The Foreign Office was in favour of co-operation on a private basis between selected U.K. industries and their German opposites. It seemed to meet German complaints that British policy was aimed at restricting German opportunities for trade and it obviated the bad impression caused by U.K. tariffs on goods mainly imported from Germany. While potential dangers were seen in the international political effects of any agreement, there was no objection in principle to the Government sponsoring such agreements.

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48. BE QV6/291, Resumé Memo. 29 July 1938. BT11 896 CRT 8278, minute by Brown, 9 July 1938. Francis, Britain's Economic Strategy, p.324.

49. FO 21647 C7853, minute, 13 July 1938.

In March 1938 Hudson told Oliver Stanley, President of the Board of Trade, that, provided that there were no insuperable difficulties he thought that the time had arrived when they should consider whether further substantial progress could be made by the Governments taking a more active role. Hudson thought that the German Government would be influenced by their desperate need for foreign exchange, while both Governments might be influenced by the favourable effect industrial co-operation could be expected to have on political appeasement.<sup>50</sup>

Hudson, however, was most unfortunate in his timing. For insuperable difficulties appeared almost immediately in the form of the Anschluss. His initiatives had to wait, therefore, until the revised Payments Agreement produced a German request for economic negotiations. Hudson hoped that these might develop in such a way as to offer the possibility of a comprehensive agreement covering not only mutual trade but the competitive positions in overseas markets, and that this might provide a stepping stone to political appeasement. He was encouraged by reports of how the Nazis were coming to realise that autarky did not pay. Yet he did appreciate that Britain could not sacrifice any of her important commercial desiderata for the sake of obtaining a political understanding.<sup>51</sup>

Apart from the continuing crisis over Czechoslovakia, Hudson's plans were not aided by the attitude of the Board of Trade. Brown, the Permanent Under-Secretary wrote simply, "The main difficulty in negotiations with Germany is that we have nothing to give and little to gain".<sup>52</sup> But Britain did have a very real economic motive for reaching an agreement with Germany. British industry continued to be threatened by German export subsidies, which were of course expensive for Germany.

Negotiations were opened after the Munich settlement when informal meetings were held at the Board of Trade on 17-18 October, as a German trade delegation passed en route to Dublin. In spite of a declaration by J.J. Willis, a Board official, to the effect that Britain was not ready to negotiate, a second meeting, attended by the FBI, was held on the return of the German delegation on 8-9 November.<sup>53</sup> The Germans asked for concessions in the U.K. market, but the FBI indicated that these would only be possible if there were a quid pro quo in third markets. Nevertheless, a basis for further talks was established and Jordan, FBI representative in Berlin, was left to arrange for these to be held in London.<sup>54</sup>

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50. FO 21705 C2239, 9 March 1938.

51. FO 21647 C7853, Hudson to Halifax, 8 July 1938.

52. BT 11 901, 25 Aug. 1938.

53. BT 11 908. FO 21648 C12720, 19 Oct. 1938.

A further motive on the German side to enter negotiations might have been the possibility that they took seriously the threats uttered by Hudson in a Commons speech on 30 November. This debate followed one at the beginning of the month on the need for reorganisation, unity and even Government assistance to help the export trades in the face of new forms of competition. Apart from trade circles, the press and Parliament itself had been applying pressure on the Government to recognise the significance of the problem.<sup>55</sup>

In the 30 November debate the Labour M.P. Emanuel Shinwell spoke of the ingenious trade machinery devised in Germany for exploiting the world markets, which had succeeded where Britain had failed. Britain had a mass of traders speaking with different voices whereas German trade spoke with one voice. After describing the effects of German subsidies on coal exports, Shinwell declared that if Germany refused to "play the game" Britain ought not to allow her to obtain all the advantages of the MFN clause.

Hudson felt compelled to speak out firmly against German methods which, he claimed, were destroying trade throughout the world. Britain had to decide how to meet German tactics such as buying at higher than world prices in S.E. Europe. British industry had to be organised to say to Germany that unless an end was made to such unfair behaviour, "we will fight you and beat you at your own game". Hudson reminded the House that Britain was much stronger financially than Germany. He pointed out, however, that where industry had been organised over the previous few months satisfactory agreements had been made with the opposite numbers in Germany. He announced that he would do his best to encourage this trend.<sup>56</sup> It seems to have been the case that in Britain, only the iron and steel industry and coal industry were sufficiently well organised to have been represented by a single body. And in the opinion of Francis, Britain's experiences of German tactics in the international cartels which existed should have warned industry in the U.K. against entering into negotiations in an unorganised condition.<sup>57</sup>

The unofficial trade talks between the FBI and the RGI were held in London on 20-21 December 1938. The RGI were interested in five branches of industry where inter-industry talks could take place, with a view to reducing the U.K. tariff for corresponding advantages for U.K. goods entering Germany. One problem was that U.K. industry was not grouped along the same lines as German industry. In contrast, the FBI was interested in third country markets and wanted to avoid uneconomic competition. They also wanted to know whether the German Government would desist from pursuing special trading methods where agreement between U.K. and German industry had been reached. If the answer was in the affirmative then the

FBI wanted further talks in the New Year.<sup>58</sup> The FBI also made separate representations to the Board of Trade that no impression could be made on German competition unless the Government was willing to undertake definite intervention in the interests of U.K. industry. The Board of Trade contended that industry had itself to remain responsible for the adaption of its sales methods to those of its competitors.<sup>59</sup>

At this point, the firmly voiced opinions of Magowan, the Commercial Counsellor at the British Embassy, began to cause a minor sensation in Whitehall. For he directly challenged the whole basis of British policy. From early 1937 Magowan had shown in his despatches how sceptical he was on the point of initiating discussions on trade and industry. With the resumption of the talks at the end of 1938, Magowan warned the Department of Overseas Trade that the discussion of export subsidies was completely outside the competence of the RGI. He doubted whether even the German Ministry of Economic Affairs would venture to initiate discussions with foreign interests where such fundamental questions of national policy were concerned. There might be no obstacles in the way of conversations between manufacturers on specific articles so long as foreign exchange receipts were not reduced.

Magowan wanted British trade relations with Germany surveyed afresh in order to give to factors other than the purely commercial the weight to which he believed they were entitled in the existing circumstances which, with Germany "practically at war" with Britain, had changed considerably since 1934. In a personal despatch to a departmental colleague Magowan revealed that since June,

"developments have been such that I cannot now bring myself to have any faith in the economic path to appeasement so long as the present German political régime subsists".<sup>60</sup>

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54. FBI 200/F/1/1/83.

55. Wendt, Economic Appeasement, p.519.

56. Parl. Deb. (H.ofC.), No.17, Vol.342, 30 Nov.1938, cols. 493-504.

57. Francis, Britain's Economic Strategy, p.327.

58. FBI 200/F/1/1/83.

59. League of Nations, British External Economic Policy.

60. BT 59 540A, Memo. 6 Dec.1938, and despatch, 7 Dec.1938.

In the Foreign Office Sargent noted that the danger which officials saw in depriving Germany of foreign exchange was that she would retaliate by repudiating the Dawes and Young Loans and, above all, the Standstill which would produce a crisis in the City for which the Government would have to be responsible.<sup>61</sup> According to Sargent's colleague Strang, the Department of Overseas Trade was rather upset by Magowan's memorandum. They sent for him to come home and talk about it since they thought that he must have been getting "rather rattled and losing his sense of proportion". Among the observations made to him was that it was unusual for civil servants merely to put questions without trying to answer them. This Magowan attempted to rectify in a second memorandum which Strang thought was an admirable piece of work.<sup>62</sup>

Similarly, the Commercial Attaché in Berlin, George Ogilvie-Forbes, claimed that the second memorandum made necessary a careful examination of Britain's trade position with Germany. The analysis was based on the premise that the Nazi régime was hostile to British interests. It also assumed that Germany depended on free sterling exchange for successful working of her exchange control. Magowan quoted in evidence an article in a German economic journal by R.H. Brand. Germany therefore needed U.K. toleration in order to operate her economic policy.

The memorandum set out a table to show how Germany was able between 1932 and 1938 to reconstitute her trade inwards from England, while observing the limits to such reconstitution set by the Payments Agreement. Magowan was in danger of giving inappropriate stress to the statistics by comparing the depth of the slump (1932-3) with the peak of a moderately strong recovery (1937). In other words, he should, perhaps, have reproduced pre-1929 figures in order to have discounted claims that the 1930s represented simply the recovery and resumption of earlier trade patterns. Yet, it was evidence to Magowan of the importance to Germany of access to the London world-wide market in raw materials and how the free foreign exchange accruing to Germany in trade with Britain was devoted to the paramount purpose of rearmament.

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61. FO 21648 C15187, 17 Dec. 1938.

62. FO 22950 C164, minute, 10 Jan. 1939.

Table 12  
German Imports of Certain Commodities from the U.K. 63

Commodity	(000's RM)		Actual Imports in 1937
	Average Imports 1932-3	Exchange made available under Payments Ag. quotas (based on 1932-3 trade returns) in 1937	
Scrap Iron & Steel	1,408	1,126	3,900
Copper	4,326	3,461	19,876
Lead	40	32	1,728
Aluminium	932	746	1,959
Platinum, Palladium & Iridium	822	658	5,765
Rubber, Gutta-Percha & waste	102	81	1,575
Glycerine	150	120	1,227

Magowan thought that at the very least it was a justifiable suggestion that the economic complex that had evolved since 1933 should be examined once a clash of interests had become apparent. So long as the appearance of sanctions was avoided, he recommended that no measure should be excluded which could be justified to the German Government as being taken in protection of Britain's legitimate national interest. What had been sauce for the German goose could serve the British gander. Magowan thus advocated an examination of the extent to which operation of the Payments Agreement had afforded inadequate control of the constituents of U.K. exports to Germany.<sup>64</sup>

Ashton-Gwatkin rephrased the question: in what circumstances, short of war, should the Payments Agreement be denounced? In economic terms he felt that it would be shocking to close down on the degree of liberty which was still allowed in trade relations with Germany; on the grounds of national defence it might become necessary to do so. Major Morton of the Industrial Intelligence Centre was convinced that the Agreement itself facilitated German war preparations; he agreed with Magowan that the Germans had considerable advantage in access to London's financial-commercial machine. But expediency rather than principle would have to be observed: an alternative source of supply always needed to be secured before the existing one was cut off. For whereas Germany's most important imports from the U.K. were coal and textiles (with which in the last resort Germany might have been able to satisfy herself from domestic resources), Britain's most important imports from Germany were machine tools and machinery. Morton suspected that it would be diffi-



difficult for the U.K. to obtain such goods elsewhere and that without them the rearmament programme would make even tardier progress than it was.<sup>65</sup>

Leith-Ross declared that it would take a lot to convince him that it was in Britain's interest to abrogate the Payments Agreement; he believed that Magowan under-estimated the advantages it gave to the U.K. Approximately one quarter of the proceeds of German exports was used to finance the service of the Standstill and long-term debts. He saw the payment of this 'tribute' as one of the best ways of strengthening Britain and weakening Germany; it also satisfied financial morality. In addition to the disruption to the City and the balance of payments if this was stopped, disruption to the export trades, especially coal, might mean a further 100,000 unemployed. The Board of Trade thought British trade to Germany so valuable that they did not agree that it should be risked in order to secure payment on debt. But Leith-Ross did admit that he had failed to convince the Board that fully manufactured goods should take up a bigger proportion of the trade: the latter were against special advantages being pressed for one branch of trade as complaints would have to be met from other branches.<sup>66</sup>

The Board itself was certainly concerned to counter the arguments advanced by Magowan. To begin with, it was denied that Germany had a balance of free sterling in payments when re-exports were taken into account. And it was claimed that at least 60 per cent in value of the exports of raw materials and semi-manufactures which Magowan suggested were of strategic importance to Germany, was made up of coal, yarn and herring. Yet the Board's own figures showed that excluding these goods, exports of other main items of raw materials including metals, had risen from £3.5 million in 1933 to £7.6 million in 1937. It was also still held that Germany could find alternative sources of supplies if U.K. channels were blocked. The Board was afraid that the U.K. market would be transferred elsewhere: Germany already obtained her wool direct from S. Africa. Finally, the Payments Agreement was defended because it did at least require Germany to take a quantity of manufactured goods rather than all raw materials and because over the previous years Britain had made substantial progress over closing the gap in the Anglo-German trade balance. Thus the real question, the Board felt, was whether to impose specific export embargoes.<sup>67</sup>

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63. T 160 821 12750/086, abstracted from Memo. 3 Jan. 1939.

64. *ibid.*

65. FO 22950, minutes, 11 & 20 Jan. 1939; Morton to Sargent, 9 Jan. 1939.

66. *ibid.* C959, FLR to Sargent, 24 Jan. 1939.

67. BT 11 1045, 31 Jan. 1939.

As might have been expected, there was more support for Magowan in the Foreign Office. His approach, of applying to the question of Anglo-German economic relations the criterion of national security rather than the normal peace-time criterion of the trade balance, was found appealing. The Foreign Office wondered how Britain's trade to Germany might be improved with measures calculated to reduce the military advantage the latter enjoyed by using London's facilities. The Treasury was informed that in view of the complexity and importance of the matter, Viscount Halifax thought that it should be referred to the Committee for Imperial Defence.<sup>68</sup>

But it was noted in the Board of Trade that it was obvious that the Treasury would have preferred to have killed Magowan's memorandum.<sup>69</sup> Together these two departments blocked plans for an inter-departmental meeting; it was claimed that the CID had already considered the problem. Phillips told the Foreign Office that the abrogation of the agreement and the imposition of a unilateral clearing upon Germany would involve difficulties and losses which would impede the war preparation of the U.K. and,

"That in their Lordships' view is the essential consideration but it is also the case that such a drastic step would be difficult to reconcile with a policy of attempting to improve political relations between this country and Germany".<sup>70</sup>

But Magowan was not be put off. In a third memorandum he tried a different approach. He did not question the fact that the Payments Agreement had been good for British exports - so much so that in 1938 Germany was the U.K.'s best customer (after India) taking £20.6 million worth compared to £20.5 million to the U.S.A and £19.3 million to the Argentine. As far as the trade allocation under the Agreement was concerned, Germany had been obliged to use 55 per cent in 1937 and 57 per cent in 1938 but had actually used 60 and 67 per cent respectively. The chief commodities to which this margin of exchange or gratuitous imports was devoted were strategic raw materials. The U.K. provided not only a margin of exchange but also the best market in which to spend it. Thus Magowan wanted Germany to revert to her 1932-3 spending pattern by importing more consumption goods.<sup>71</sup>

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68. T 160 821 12750/086, FO to Treasury, 20 Jan. 1939.

69. BT 11 1045.

70. T 160 821 12750/086, 2 March 1939.

71. *ibid.* 7 March 1939.

On 15 March Germany occupied Prague. This made Magowan's thesis all the more poignant to Sargent. But he despaired of the Foreign Office ever being able to reach a satisfactory conclusion to it if they had to fight their way through the "tangled undergrowth of Departmental obstructionism". Sargent gained Halifax's approval for the idea that the issue should be raised at Cabinet level.<sup>72</sup>

The Foreign Secretary therefore wrote to the President of the Board of Trade to say that the deterioration in Anglo-German relations made it advisable to reconsider the question of the Agreement on broad grounds of policy. The President was reminded that he had himself said in Cabinet that Britain and Germany were virtually in a state of war. Would it, it was asked, be in Britain's interest to maintain the agreement after the outbreak of war against Germany? In an internal minute Sir William Brown answered, "No. And in these conditions it would be in our interests to bomb Berlin. Should we do that now?". The official reply from Stanley to Halifax rejected the idea of revision until it was decided to bring down the German economic system in ruins at whatever cost to British trade and general peace. Halifax thus had to retreat once more, taking solace from the fact that German exports had begun to fall off rapidly with a consequent diminution of free sterling exchange.<sup>73</sup>

### iii) Meetings between Representatives of the British and German Governments and the Agreement on Coal.

Magowan's thesis and the Foreign Office's calls for action were rejected by the Treasury and the Board of Trade as they ran counter to the prevailing policy, rather than because of the balance of economic argument. The object of this policy was to consider ways in which economic assistance might be given to Germany in return for a political undertaking. The Magowan debate took place against the background of the developing contacts between the FBI and the RGI. Yet although the British Government maintained publicly that the FBI was acting on its own initiative, a number of high level contacts between representatives of the British and German Governments were planned to coincide with the industrialists' negotiations. This policy was initiated at the time of the first trade talks in late 1938. It received considerable encouragement when an agreement between the coal industries in the two countries was reached. But it was not abandoned after the invasion of Prague effectively ended the plans of the industrialists.

The methods by which external assistance could be given to Germany were considered in a Treasury memorandum. One idea with which the Government had apparently been toying for some time was that developed by the Governor of the Bank of England: amelioration of Germany's foreign debt position and

improvement of her credit abroad to enable her to obtain commercial credit in the ordinary course of business. Germany would have to pay all interest in cash instead of bonds, though the actual rate could be reduced in agreement with the bondholders. The foreign exchange required for this would have been above Germany's level of reserves but credits might have been forthcoming. The memorandum also considered the question of exchange rates and how far it would be possible to persuade Germany to accept the policy of the Tripartite Agreement. It was thought that she would have to devalue by 40-50 per cent to have any chance of building up sufficient gold reserves. The long-term threat to British trade implicit in such a move was not forgotten. In such difficult circumstances the promise of industrial agreements provided a hopeful course and the Government was, "ready to promote discussions between the coal syndicates". If, instead of waiting for Germany to devalue, she was invited to enter the Tripartite Agreement, it was believed that she would probably demand stabilisation credits and trade concessions which Britain and still more the U.S. and France would find difficult to accept. 74

When Dr. Schacht contacted his friend Montagu Norman to say that he had obtained Göring's permission for a visit to Britain and that he was anxious to meet Norman and Ministers to discuss economic questions and solutions to the Jewish problem, Chamberlain told the Cabinet that, in the difference of opinion between the moderates and extremists in Germany, everything should be done to encourage the former.<sup>75</sup> Schacht's visit took place in December 1938. He met Ashton-Gwatkin and then Leith-Ross. The British officials reported that it was obvious that Schacht was distancing himself from the Nazis. He openly admitted that no one had any influence on Hitler, but he spoke warmly of the Reichsbank which he referred to as an island of good men (which was, of course, to be fully conquered by the Nazi Party following the dismissals of Schacht, Vice-President Dreyse and others in January 1939). The possibility of a new loan to Germany was raised but Schacht was not keen to pursue the idea.<sup>76</sup>

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72. FO 22950 C2581, minute, 19 March, 1939.

73. BT 11 1045, Halifax/Stanley correspondence, 31 March, 6 & 28 April, 1939.

74. T 172 1863, unsigned memo. 16 Nov. 1938.

75. CAB 23/96, 57(38); 30 Nov. 1938.

76. T 188 227, minutes by Ashton-Gwatkin, 15 Dec. 1938 and FLR, 16 Dec. 1938.  
FO 21646 C15621, 16 Dec. 1938.

Indeed, the capacity in which Schacht visited Britain was not, officially at least, as a representative of the German Government. The Cabinet decided that he should not be referred to publicly in case his domestic position was weakened. Halifax counselled great caution in giving any assistance to Germany in connection with the scheme for helping Jewish refugees which Schacht had proposed. Schacht had also met Chamberlain and it was suggested that Leith-Ross might go to Germany with Dr. Funk paying a return visit. It was also suggested that Stanley might go to Germany; he told the Cabinet that the matter of neutral markets had been brought up with Schacht and that it was possible that a satisfactory agreement might be reached. This was also the case with coal, where an agreement between the employers' organisations was being negotiated through intervention by the two Governments after negotiations between the former had broken down.<sup>77</sup>

Ashton-Gwatkin took up an invitation to visit Göring in a private capacity. But the visit, arranged for January 1939, had to be postponed until February because of the publicity which Schacht's visit and Norman's return visit to Berlin had aroused. Halifax felt that yet another visit following so quickly might lead to undesirable comment or an unwelcome crop of rumours that some large measure of financial and economic co-operation with Germany was in contemplation.<sup>78</sup>

At the end of January 1939 Anglo-German relations entered a new phase, or so some optimistically believed in London. Chamberlain met the German Ambassador, von Dirksen, and thought him to be sincere when he declared that he believed that Hitler was not planning any aggressive moves but was chiefly concerned with Germany's economic position and the means of increasing exports. Chamberlain had no doubt that Germany's economic position was deteriorating.<sup>79</sup> Indeed, on 30 January Hitler's Reichstag speech was notable for its moderate tone and emphasis on how Germany had to "export or die".

The next day an encouraging breakthrough occurred in the coal industry talks. While the FBI and RGI prepared the ground for further talks, meetings of a semi-official nature were held in London in January and February between representatives of the British and German coal industries. The agreement reached on 31 January was, opined the Foreign Office, by no means unfavourable to Britain.<sup>80</sup> The German delegations stayed on in London and the details of the agreement were made public in early March.

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77. CAB 23/96 60(38), 21 Dec. 1938.

78. FO 21660 C15690/C16042, Ashton-Gwatkin & Strang to Berlin Embassy, 10 Jan. 1939.

79. NC 18/1/1083, letter to Ida, 28 Jan. 1939.

Imports of U.K. coal and coke into Germany were governed by the Exchange of Notes of April 1933 whereby the minimum quota of 180,000 tons per month was increased in proportion to any increase in German consumption above 7.5 million tons per month. Towards the end of 1936 there was a short-fall in the quota by 5 per cent. This reduction might have taken place simply because of rises in the U.K. prices and the consequent weakening of Britain's power to compete. But a more likely cause was felt to be the application of German price control measures. But it was decided to make no approach to the German Government because it was held that the U.K. coal trade had benefited more from the increased quota than German trade to Britain had from the reduced tariffs secured under the agreement.<sup>81</sup>

The most serious challenge to the British coal trade, however, lay in the determination of Germany to challenge Britain's supremacy in world markets. In 1929 German coal exports were equivalent to 50 per cent of British exports. By 1937 they had risen to 90 per cent through the use of greater subsidies. Germany had mooted the idea of an Anglo-German cartel at the World Economic Conference in 1933. But it was not until 1938 that indications were made in Berlin that negotiations could take place. The German object was to consolidate the vast gains made with a view to ending subsidies.<sup>82</sup>

The basis of the new agreement was that the relation of British to German exports was to be in the ratio of 65:35. Undercutting was to cease: both countries were to sell at prices which were to be agreed upon by a trade association composed of industrialists of both nations.<sup>83</sup> The agreement was widely hailed as a prelude to the formation of a European coal cartel. But the operation of the agreement was suspended as a result of the invasion of Czechoslovakia and was never to take effect.

In Cabinet discussion of 1 February Stanley said that it was possible that a celebratory dinner was to be given in London by the British coal trade to which Funk would be invited. It could then be hinted that any reciprocal invitation would be accepted by the President of the Board of Trade. Leith-Ross had already been to the German Embassy to discuss this.<sup>84</sup>

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80. BT 11 1056, FO 22950, minute by Ashton-Gwatkin, 31 Jan. 1939.

81. BT 11 736.

82. Francis, Britain's Economic Strategy, p. 251.

83. The Times, 2 March 1939.

84. CAB 23/97, 3(39), 1 Feb. 1939; FO 22950 C1343, FLR to Stanley, 31 Jan. 1939.



The mood of optimism continued throughout February. In addition to his belief that the effect of Munich had been of advantage to the democracies, Chamberlain claimed that everyone knew that the economic situation in Germany was bad so that Hitler had to acknowledge it publicly. This was not, the Prime Minister felt, a position in which to start a deathly struggle.<sup>85</sup> He had received reports which supported each other and gave a different picture from that painted by Vansittart. According to Chamberlain's information, Hitler and Ribbentrop, so far from hatching schemes against Britain, were searching around for some means of approach without the danger of a snub. They were worried about the economic situation in Germany and they felt that Britain might help them to improve it if she would. Chamberlain had been told that Ribbentrop was even planning a visit, "and in the meantime we have quietly arranged for Oliver Stanley to pay a visit to Berlin".<sup>86</sup>

Funk was unable to leave Berlin through pressure of work but Stanley and Hudson were to be invited to Germany. This was given prominence in the German press, and on 20 February Ashton-Gwatkin met Ribbentrop.<sup>87</sup> Chamberlain described as "important and striking" a further incident. In reply to a speech made by Henderson (the British Ambassador) at an Anglo-German Fellowship dinner in Berlin, the Duke of Coburg's speech was changed at the last moment, perhaps by Hitler. Among other things the speech welcomed the coal agreement and the prospects of further industrial negotiations, which the Duke said would be followed with deepest interest. Chamberlain planned to reply in a speech the following week taking up these references.<sup>88</sup>

With the notable exception of the Ambassador himself, other members of the Embassy staff rallied to the support of Magowan in his criticisms of policy. Pinsent, for example, told London that it would merely confirm the German notion of British weakness if talks continued on the supposition that the Germans needed help economically and would become reasonable if they received it. Britain had to show her teeth unobtrusively in a general determination to give nothing away. Pinsent believed that the attempts to reach a coal agreement had dragged on for years until Hudson had made his strong speech in the Commons. Pinsent also characterised the Nazi régime as like Dr. Jekyll (Schacht) - reasonable and internationalist, and Mr. Hyde (Hitler) - the party extremist. In a memorandum written to prepare Stanley for his visit, Leith-Ross disagreed with this distinction. For although Schacht had appreciated the need for economic exchange, he had always been a strong nationalist and had only been able to maintain his non-party position by always driving a hard bargain. Leith-Ross felt that it was easier to do business with a relatively inexperienced politician who had authority than with an expert who had to safeguard himself. Yet the Chief Economic Adviser took the point



that it would not necessarily be a bad thing if the Germans approached the trade talks believing that Britain would be ready for a trade war if they broke down.<sup>89</sup>

Beset by doubts, Henderson rather tortuously recommended a middle course. He wondered whether Britain could co-operate on a scale not sufficient to affect German rearmament but which might have been just enough in itself to give the German mind the impression that voluntary renunciation of excessive rearmament might lead to a large measure of goodwill from Britain. The Ambassador thought that it would be "bad publicity" to discourage co-operation between the industrialists provided that it was arranged on a strictly business basis; it was doubtful whether Germany could increase exports and armaments at the same time.<sup>90</sup>

The Military Attaché to the Embassy appeared to recommend precisely the opposite course. Colonel McFarlane wrote, "from the purely military point of view anything that assists Germany to maintain or increase her export trade must appear undesirable." McFarlane approved of the gesture of Hudson and Stanley visiting, along with the FBI, because it would make it harder for Hitler to claim that it was entirely Britain's fault that Germany's export trade was losing ground. But McFarlane warned that Germany would break any bargain of trade facilities for reduction in armaments. It was therefore unwise of Britain to ease the economic screw; the world was already convinced of Britain's lack of will to stand up to Germany, and there were suggestions that the main motive behind the trade mission was political not economic.<sup>91</sup>

iv) From the Düsseldorf Convention to the Meetings with Wohlthat.

After the Board of Trade had studied the provisional list of German proposals for reductions of customs duty in the U.K. they declared that there seemed to be little scope for a trade agreement on ordinary lines. The Payments Agreement, for example, ~~would~~ have to stand by itself. A basis for agreement would

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85. NC 18/1/1084, letter to Hilda, 5 Feb. 1939.

86. NC 18/1/1085, letter to Ida, 12 Feb. 1939.

87. FO 22950, C1896/C2223/C2345.

88. NC 18/1/1086, letter to Hilda, 19 Feb. 1939.

89. T 160 866 15447/021/1, Pinsent to Ashton-Gwatkin, 31 Jan. 1939; Memo. by FLR, 13 Feb. 1939.

90. T 160 821 12750/086, Henderson to Halifax, 3 March 1939;

91. *ibid.* Memo. 27 Feb. 1939.

exist if an undertaking could be obtained from Germany that methods of 'unfair' competition would cease in third country markets. The Government was very unwilling to accede to the pressure to assist with some sort of subsidy, even though there was confidence in Britain's superior financial strength in any competition in export subsidies.<sup>92</sup>

In February 1939 a FBI delegation met the President of the Board of Trade to ask what protective measures for the export trades would be forthcoming if the German negotiations broke down. Stanley answered that the agreement on coal had given them every reason to think that the German Government was very ready to lend its influence on the side of an agreement and that it was essential to take advantage of that position.<sup>93</sup>

On 1 March the FBI held a meeting in London, with Sir William Larke in the chair, in preparation for what was now called the Anglo-German Industrial Convention. The basis for negotiation had been agreed: prices and quantity of exports in third markets. A general understanding was hoped for but it was pointed out that individual industries would have to make the agreements and that the FBI would bring no pressure to bear in this respect. The meeting was also told that the FBI had received an assurance from the President of the Board of Trade that if the talks failed the Government would take all necessary measures to protect British industry. It was also suggested that before an agreement could be reached there would need to be definite action by the Government. <sup>94</sup>

As the day of the Convention approached, Magowan reported from Berlin. He analysed why the progress of the negotiations had been so slow. The Germans were bondsmen of the totalitarian system and found it difficult to commit themselves to anything without the prior approval of the Ministry of Economics. The British, on the other hand, were slaves of a liberal economic system and so had difficulty in organising themselves so as to speak with a united voice in each industry. Magowan welcomed the coal agreement: it paved the way and had shown that the Germans were alive to the dangers of a trade war in third markets. At the same time he thought that the Germans were in a thoroughly muddle-headed condition; British access of zeal in sending out observers, ministers and industrialists would tend to accelerate a decision to co-operate or would disclose thorough evasion and intransigence. In the Treasury it was also noted that there were no grounds to expect economic concessions on the British side nor could one expect much from the RGI who had not even commented on the FBI agenda but rather planned festivities in Dusseldorf.<sup>95</sup> Indeed, Locock and Sir William Larke of the FBI delegation were old friends of Poensgen, head of the German delegation, and von Schnitzler of I.G. Farbenindustrie.<sup>96</sup>

The Convention took place on 15-16 March 1939. But the festivities must have been marred by the news of Hitler's occupation of Prague on 15 March. In the Cabinet discussions in London on that day Stanley was worried that the postponement of his visit might have serious results, such as the breaking off of the trade talks by the German Government. In that event the British Government would be strongly pressed to stand by the exporters in order to allow them to compete. Stanley did think that the visit had to be called off but that no statements should be made, "which would render it difficult to resume the economic discussions at a later date". Chamberlain duly told the House of Commons of the visit's cancellation.<sup>97</sup>

In Düsseldorf, an agreement was arrived at before it was decided in London that Hudson and Stanley should not go to Berlin. The British Government advised the FBI representatives before they signed the document to carry on. The joint declaration did not in itself regulate Anglo-German competition but it laid down the framework within which individual industries could co-operate. Negotiations between ten industrial groups were in fact taking place.<sup>98</sup> The declaration indicated a determination to replace competition in export markets by price fixing and marketing agreements. It was reported that reaching agreement was so important that both Germany and Britain were prepared to alter other agreements with third parties.<sup>99</sup> The delegates at the Convention decided to form a standing committee and the FBI invited German representatives to London for June. It was perhaps for this reason that Vansittart had urged Halifax on 15 March to recall the FBI mission immediately so that the effect of the cancellation of the visit by the ministers should not be invalidated.<sup>100</sup>

At the end of March the FBI met to consider the results of the Convention. What was termed "the difficulties" in central Europe had put a brake on the discussions and agreements. The FBI was looking to stall further discussions until "public opinion on this side had to some extent died down". In all cases, it was felt, there was to be no publicity. But the FBI believed that the decision between negotiation and a trade war would have to be faced eventually.<sup>101</sup>

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92. FO 22950 C96, Strang to Ogilvie-Forbes, 13 Jan. 1939.

93. BT 64 44, 6 Feb. 1939.

94. FBI 200/F/1/1/83.

95. FO 22950 C 2881. T 160 366 15447/021/2.

96. FBI Secretary's papers (Walker files), 14/2.

97. CAB 23/98, 11(39), 15 March 1939.

98. FBI Secretary's papers (Walker files), 110/3, Memo. 10 July 1947.

99. The Times, 22 March 1939.

100. FO 22950 C3084.

101. FBI 200/F/1/1/83, 30 March 1939.

With the invasion of Czechoslovakia the British Government blocked all Czech accounts in London. The Treasury official Waley indicated that these blocked accounts could be used in negotiations over British blocked balances, non-payment of interest on loans, and the freeing of foreign exchange to assist Czech refugees. But the problem was that negotiations could not take place while the legality of the annexation was not recognised. 102

Some £6 million in Czech gold was held in a BIS account at the Bank of England. When the BIS, under the influence of its pro-Nazi directors, instructed this to be transferred to the Reichsbank, neither the Bank of England nor the Treasury had the legal right to refuse the request as through convention BIS assets were granted immunity. The transfer of the gold became public knowledge only two months later in June.<sup>103</sup> In May a German delegation arrived secretly in London to discuss Czech assets but departed empty-handed after questions in the Commons had led to a debate on the subject on 26 May. Einzig claimed for himself the honour of being responsible for arousing interest in the affair. At the end of May the German Government agreed to a revision of the Payments Agreement to cover debts owing from the Sudetenland, and the document was signed on 16 June.<sup>104</sup>

The FBI was not alone in looking forward to the time when trade talks could be resumed. Chamberlain informed the Cabinet that it was quite impossible to discuss with Germany the colonial question (Hitler had just denounced the Anglo-German Naval Treaty), and that nothing should be done to imply that Britain was prepared to do so. Yet, the Prime Minister also thought that within a reasonable time, if there were no further disturbances in international affairs, the promising trade negotiations might be resumed. However, although the FBI corresponded with the RGI at the end of June, no further meetings were planned.<sup>105</sup>

In order to appreciate how financial policy and foreign policy inter-acted in prewar Britain, it is necessary to consider the British view of the state of Germany's economy and the effects of rearmament on the British economy. Even the modest level of rearmament achieved in 1937 and 1938 tended to produce an adverse trade balance of £55 million in each year. Fears for the future of sterling and the need for rearmament produced indications that confidence in Britain's financial position was weakening in 1938 and 1939. Peden has shown how the Foreign Office, from the beginning of 1937, believed that Germany would have to decide for economic reasons within a year whether to limit arms expenditure or to embark on a foreign policy adventure rather than face economic collapse. This thesis dictated that Britain should immediately spend more on rearmament. Peden points out that belief in Germany's alleged Achilles heel of dependence on raw materials rested upon an inadequate

system of economic interlligence, and that the view of the importance of conventional economic factors in Hitler's decision-making was mistaken. The Treasury were right to be sceptical of the Foreign Office thesis, even if, ironically, the latter were right (for the wrong reasons) to urge that a decision was at hand.<sup>106</sup>

In early July the Cabinet considered a memorandum which claimed that Germany had come to rely more on immensely heavy taxation of the working class than on borrowing. This was coupled with far lower rates of expenditure on social services. Sir Richard Hopkins noted, however, that so far as internal finance was concerned he believed that Germany would go on rearming indefinitely. As for external finance, Germany was bankrupt, but the position was kept going by very severe controls. Hopkins thought that there was no likelihood of a breakdown of the system in the near future.<sup>107</sup> In early 1939 Chamberlain believed that all his information went to show that the Germans were in no mood for war and that Hitler was pre-occupied with his economic difficulties.<sup>108</sup>

It is in this context that the extraordinary talks between Sir Horace Wilson (Chief Industrial Adviser) and Wohlthat and between the latter and Hudson have to be placed. This episode provided the final futile attempt to preserve peace by means of working towards some kind of Anglo-German politico-economic agreement. The economic negotiations which commenced with the FBI-RGI talks and grew out of a trade drive for British exports against German trading methods, were to end in attempts at economic appeasement.

Wohlthat, a director in the administration of the Four Year Plan and thus a close economic adviser to Goring, had already met leading civil servants and City figures in June 1938 when he visited London in connection with the International Whaling Conference.<sup>109</sup> In Berlin, in May 1939, unofficial intermediaries secretly reestablished contact concerning the economic talks. This was put on to a diplomatic level when Wohlthat visited London the next month in connection with the Whaling Conference and the refugee problem. On this occasion Wohlthat met Ashton-Gwatkin and Wilson. He proposed to Ashton-Gwatkin an economic settlement in which Britain would recognise the German sphere of influence in S.E. Europe.<sup>110</sup>

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102. BE OV34/206, SDW to FO, 25 March 1939.

103. Francis, Britain's Economic Strategy, p.328; Einzig, Appeasement, p127; Financial Times, 9 June 1939.

104. Einzig, In the Centre of Things, pp.186-94. F O. 22952 C7795. It emerged later that the Czech gold was never physically transferred. The particular BIS sub-account at the Bank of England was closed, but by the outbreak of War the Reichsbank had given no instructions for the gold to be moved from London to Germany.

Returning to London Wohlthat had further talks with Wilson (18 July) and with Hudson (20 July). Controversy has raged around these conversations ever since; it remains difficult to assess the veracity of the records left by the participants. Wohlthat's memorandum of his talk with Wilson contains proposals put forward by the latter for a far-reaching settlement, including a settlement of Germany's debt problems and loans for the Reichsbank. Wilson's record contains no such proposals. 111 Hudson claims that he told Wohlthat that,

"if Hitler was prepared to disarm and to accept adequate safeguards against rearming the possibility was opened up of establishing Germany on a strong economic basis". After signing the Whaling agreement and meeting Waley over the question of Czech gold, Wohlthat left London. 112

On 22 July the British press, in particular the Daily Telegraph and the News Chronicle announced that Britain had proposed a fantastic loan to Germany. The news shocked all of Europe. The origin of, and motive behind, the rumour can only be supposed. Von Dirksen told Sargent that Wohlthat's description of the conversation with Hudson was very different from the press articles. 113 Indeed, in his report to Berlin, the German Ambassador put the blame on Hudson's morbid desire for self-assertion and his loquacity, which provided an opportunity for "war-mongering correspondents" and their "henchmen", such as Churchill and the Foreign Office. 114 Sir Alexander Cadogan shared this view of Hudson whom he described as "an eel". Cadogan believed that Hudson himself had been responsible for earlier press leaks concerning the planned visit to Germany by the Ministers. 115

An angry Chamberlain was left to face a storm of protest in Parliament as he sought to distance the Government from the rumours. But the question had remained as to how far Hudson was acting on his own initiative in any proposal that he might have put forward. Fortunately, Chamberlain himself has left a candid record of the affair. He wrote that entering into conversations with Germany had been made worse by the appearance of another rumour of a loan,

"which in three different papers I looked at yesterday was of £100, £500, and £1000 million respectively!". Hudson had made no mention of a loan in his account to Chamberlain, but the latter was not sure that he had been told the whole truth. Chamberlain thought Hudson a clever fellow with a persuasive tongue, but also one with a reputation as a disloyal colleague who was always trying to advance his own interest at the expense of his friends. It was a favourite device of Hudson's to take ideas on which other people had been working for years, and put them forward as his own and as if nobody else had even thought of them. Chamberlain continued, "The ideas which he put to Wohlthat for instance, as his own personal suggestion, on an economic arrangement (not including a loan) are just those which we have been discussing in



the Departments for 12 months". According to Hudson, Wohlthat had declared that these ideas were entirely new, including ones on colonies which Chamberlain noted had already been suggested to Hitler. They had seemed acceptable to Wohlthat from the German point of view and he had said that he would report them to Göring. Chamberlain thought that "Master Hudson" was so pleased with himself that he had been talking to the press, with disastrous results. The Wilson-Wohlthat talks had not covered these ideas, but the interview had become known, perhaps through Wohlthat, "and so now the loan idea is given a demi-semi-official air and all the busy-bodies in London, Paris and Burgos have put two and two together and triumphantly made five".<sup>116</sup>

One week later Chamberlain wrote that Hudson's "gaffe" had done a lot of harm and showed how completely he lacked the sense of responsibility which a minister should have. Chamberlain did not intend to add to his own troubles by sacking Hudson at that time, but "In the meantime there are other and discreeter channels by which contact can be maintained for it is important that those in Germany who would like to see us come to an understanding should not be discouraged".<sup>117</sup>

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105. CAB 23/99,26(39), 3 May 1939. FO 22952 C9098, 29 June 1939.

106. G.C. Peden, 'A Matter of Timing : The Economic Background to British Foreign Policy, 1937-39', History, Vol. 69, Feb. 1984, pp.23-6.

107. CAB 23/100,30(39),CP 148(39),5 July 1939.

108. NC 18/1/1087, letter to Ida, 26 Feb. 1939.

109. DGFP, Series D. Vol. II, No. 279, Report by Wohlthat, 4 July 1939.

110. Wendt, Economic Appeasement, p.604. S. Aster, 1939 : The Making of the Second World War (1973), p.233. DBFP, 3rd series, Vol. V, No. 741, minute by Ashton-Gwatkin, 7 June 1939.



It would seem fair to claim, therefore, that while the details of the scheme were Hudson's, in substance they represented official policy. But whether the Government was able to continue with this policy after this episode must remain a matter for speculation. Certainly, as far as the Prime Minister was concerned, the logic of the policy, with its emphasis on moderates in the Nazi Government, still held good. Montagu Norman wrote to the Chancellor to defend himself against charges which Dalton (Shadow Foreign Minister) had made in the House of Commons (on the authority of some unnamed journalist who was doubtless Einzig), to the effect that at a BIS meeting, Sir Otto Niemeyer and Norman had endeavoured to persuade Dr. Funk to devalue the Reichsmark in return for a foreign loan. Norman angrily claimed that there was not one atom of truth in the report. 118

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111. DGFP, Series D, Vol. VI, No. 716, Berlin, 24 July 1939. DBFP, 3rd Series, Vol. VI, No. 354, 18 July 1939. C.A. MacDonald, 'Economic Appeasement and the German "Moderates" 1937-1939', Past & Present, 56(1972), p.129. MacDonald finds it likely that Wohlthat's account inflated the contents of the talk in the hope of attracting Hitler and that Wilson probably said or implied more than he subsequently claimed. MacDonald has little doubt that the approaches to Wohlthat were sanctioned by Chamberlain as a last attempt.

112. DBFP, 3rd series, Vol. VI, No. 370, 20 July 1939. DGFP, Series D, Vol VI, No. 698.

113. FO 22990 C10371, Sargent minute, 24 July 1939.

114. DGFP, Series D, Vol. VI, No. 718, 24 July 1939.

115. D.N. Dilks, ed. The Diaries of Sir Alexander Cadogan O.M. 1938-1945 (1971), pp.128 & 150.

116. NC 18/1/1108, letter to Ida, 23 July 1939.

117. NC 18/1/1110, letter to Hilda, 30 July 1939.

118. T 172 1903, 2 Aug. 1939.

## CHAPTER IX

### Conclusion

British financial and economic policy towards Germany in the 1930s was clearly dominated by foreign policy considerations. Yet policy also reflected the long history of financial and economic contact between Britain and the Germanic world. Certain conclusions may be drawn about the nature of that policy.

The major objective of British politico-economic policy towards Germany in 1931-2 was the cancellation of Reparations. One or two dissentient voices were raised in the debate over the wisdom of cancellation but the Cabinet, Treasury, and financial institutions were firmly committed to such a policy. Yet, in the Foreign Office Vansittart's attitude was equivocal. He desired to see Reparations ended but in exchange for a 'political truce' with Germany. In his view, people in Britain were quite right to feel that Germany ought not to get everything for nothing. Moreover, Vansittart believed that this feeling, though perhaps not shared by the bankers or the Treasury, was fairly widespread.

But, in spite of the warnings of the British diplomats in Berlin, and although British ministers and their advisers were alive to the dangers of delay in securing the policy objectives in respect of Germany, the postponement of the Lausanne Conference (which Britain encouraged) undoubtedly helped to hasten the end of the Weimar Republic. If policy-makers were waiting for the most suitable international climate to ensure that the conference had the greatest chance of success then, in the deteriorating conditions of the 1930s, they risked indefinite postponement.

Another aspect of British policy had a more direct effect on Germany. There are indications that the combined results of Brüning's ruthless deflation policy, the Standstill Agreement, and the Lausanne Conference might have succeeded in turning around the German economy. But the effort to attain price and exchange equilibrium was brought to nothing by the depreciation of sterling. While the departure from Gold occurred too quickly to allow much consideration of the international political and economic ramifications of such a move, the British Government failed in the following weeks to appreciate the full significance of the role of sterling for political developments in Germany. Indeed, it was not until 1934 (when the Nazis had already achieved power), that Treasury officials appear to express a guilty concern at the self-interested part Britain had played in the world economic crisis. Undoubtedly this concern influenced officials in attempts to reach agreement with Germany.

In 1933 the question of debt servicing moved from the sphere of individual contact into international politics. From this point it became related to the most important issue of the day, that of rearmament. Indeed, from Britain's point of view Germany's departure from the Disarmament Conference and League of Nations and the dictatorial transfer rulings were all linked and represented a unilateral and discriminatory withdrawal from international obligations. The whole of British policy towards Germany was placed under a great strain, and the eagerly-sought agreement began to seem more difficult to achieve.

From 1933 Whitehall energetically attempted to form the most realistic picture of Nazi Germany, and to clarify the issue at stake. In both respects success was only partial. Officials were faced with a dilemma. They had to decide whether by withholding economic concessions Germany's privation would prevent rearmament, or whether growing prosperity would provide an antidote to political extremism. With the development of the belief in 'moderates' and 'extremists' in the Nazi regime, the problem became one of offering concessions in the right circumstances, at the right time, in order to encourage the former and restrain the latter. For Vansittart, the right circumstances had not shown themselves by the beginning of 1934 and he, at least, quickly turned against the idea of unilateral concessions.

But the Foreign Office represented just one point of view, namely that economic concessions should only be made when the political circumstances had been taken into account. The issue of debt servicing illustrates the variety of influences acting on the formulation of British policy at that time, and the rather ill-defined powers and areas of competence of the responsible departments of the government and financial institutions. Indeed, the Foreign Office began to show extreme hostility to the ideas and attitudes of the Bank of England and of Montagu Norman in particular.

Certainly it would appear that a large measure of the reluctance of officials to embark on a policy of clearings was attributable to the influence of banking circles. Calls for a stringent exchange control arrangements (as practised in a large and increasing number of countries) were resisted by policy-makers. Instead, the novel device of the Payments Agreement was erected. Banking interests in general were afraid that any form of exchange clearing system might deprive them of part of their business. Furthermore, bankers were not anxious to squeeze Germany for larger payments even for their own benefit, let alone for the benefit of long-term creditors. The justification

for this stance was found in belief that the Standstill would be put in jeopardy. The Bank of England's support was enlisted to oppose any clearing arrangement. More than this, the Bank was prepared to take extraordinary and clandestine measures to ensure the success of the Payments Agreement. Only now is it possible to establish the full details of the Bank's involvement.

The policy which resulted in the financial agreements of 1934 was largely formulated and executed by a small group of Treasury officials. They had the difficult task of attempting to strike a balance between British financial and economic interests which, in 1934 and again in 1938, were in open competition with one another for the Government's protection or recognition of their position. Perhaps the banking community was only too ready to believe the threats which issued from Germany that the City's intricate systems would be disrupted, either deliberately or ineluctably, by a clearing. But it is not possible to say that the dangers were exaggerated. British financial institutions did not collapse in 1931 like several of their foreign counterparts. But the psychological and material effects of the crisis and its aftermath on the individual London banks can only be estimated. Although financial interests were given as much, if not more, consideration than others, the Treasury retained a relatively objective outlook and did not think, for example, that the Standstill would be endangered.

The dilemma over whether to supply vital raw materials to Germany was never really resolved. The deteriorating political situation in the second half of the decade naturally dictated an approach more prudent than before. For when, in the early years of Nazi rearmament, those companies supplying raw materials to Germany experienced severe trading difficulties, British officials were more concerned that the commercial livelihood of the companies should not be impaired. At the same time there was a widely held belief (with the notable exception of many in the Foreign Office), that any interruption to Anglo-German trade might provoke a worsening in Germany's domestic and international political position - the very thing which Britain wanted to avoid most. It was appreciated that a firm like I.G. was at the centre of the German rearmament effort. But the problem facing British policy-makers, which they only slowly came to realise, was that it was unrealistic to draw distinctions between different German companies in such a command-type of economy which was itself so powerfully directed towards furthering rearmament. But the question then became one of whether to trade at all with Germany. The consequences of not trading were thought by most to be too awful to contemplate. The consequences of trading were at least uncertain.

In the course of 1936 and 1937 the thrust of economic policy-making towards Germany was mostly in the direction of attempting to foster agreements between industries in the two countries. At the beginning of 1936 the Foreign Office idea of reaching agreement concerning export markets in Europe as part of a political agreement received widespread discussion and criticism. But then support for reaching any kind of agreement temporarily evaporated after the reoccupation of the Rhineland.

The notion of reaching economic arrangements with Germany was next purveyed in response to the growing problem of uneconomic competition. The motive behind the policy was primarily to help British industrial agreements. But why did the Government not organise a more aggressive counter-attack? It is certainly the case that the need for agreements became less urgent as the economic situation improved in early 1937 (only to grow worse again in 1938). And part of the answer might lie in the fact that government did not consider it to be one of its responsibilities to organise industry in such a fashion. Industrialists might have been less encumbered by bureaucratic regulations than their successors, but neither did they enjoy a great deal of governmental moral or physical support in such cases. The nearest the Government came to starting on the path of intervention was in Cabinet discussion of Leith-Ross's memorandum, in which he advocated a more energetic arrangement of export credit guarantees.

But much more importantly, the manner of Hudson's initiatives in 1937 indicates that the Government's thinking had not changed substantially in the course of two years: accommodation rather than retaliation was still seen as a way out of the impasse with Germany. Why, therefore, did so little come of the efforts to arrange agreements between industries? Certainly there were circles which did not approve of the principles of cartels and price-fixing arrangements with Germany. The Foreign Office and the Commercial Counsellor in Berlin both advocated caution - for political rather than economic reasons. But the negotiations could not progress within the terms set for them, namely on an industry to industry basis. For, on the one hand the British Government did not desire to play any role in the talks, and on the other hand political control of industry in Germany extended even further than the FBI feared.

The 1934 Payments Agreement was the bed-rock of financial and economic policy towards Germany. Indeed, it was considered to be a vital mechanism for the conduct of Anglo-German relations as a whole. When all the financial, economic and political factors are taken into consideration it would appear that the arguments for and against the agreement were finely balanced for much of the decade. In 1938 British officials were forced to undertake a vigorous defence

of financial and trade interests in the crisis which followed the Anschluss. There was considerable relief in Whitehall that negotiations had resulted in the amendment of the Payments Agreement rather than in the imposition of a clearing.

Yet it was from inside the government machine that the most serious challenge to the agreement was mounted. The agreement survived until the outbreak of war; in this respect it is possible to argue that the operation of such an arrangement amounted to an act of economic appeasement. It was widely recognised in 1938-9 that there were grounds for denouncing the agreement: it was contrary to Britain's interests to allow Germany to collect the considerable proceeds of her export surplus in free sterling which enabled her to buy potential war materials. But it was also held that renunciation would not make the Germans any more co-operative. Furthermore, the Treasury and Board of Trade were successful in claiming that financial and economic considerations should continue to prevail over questions of national defence raised by Magowan and the Foreign Office.

In reality, the Payments Agreement continued to be indispensable because it had become a vital plank in the political approach to Germany taken by Britain. In part, this approach still rested on the mistaken assumption that the Nazi régime comprised moderates and extremists. In addition to the revision of the Payments Agreement, the coal agreement and the renewed contacts between the FBI and RGI encouraged the hope that economic agreement would pave the way to political understanding. The meetings with Wohltat shortly before the war show that the Chamberlain Government never totally abandoned such hopes.

Finally, in turning to the Standstill Agreements, it might seem at first sight that the German short-term debts held by London banks were a significant factor in helping to determine the nature of British policy towards Germany. And it has to be asked why, of all the creditor nations of Germany, only Britain maintained, even until the outbreak of war, such a large volume of credit lines originally frozen in 1931.

Most importantly, claims that there was a fusion of interests between the financial institutions of the City and the Government cannot be substantiated. The evidence of the Standstill does not support the assertion that the relationship between the two sectors was of a conspiratorial nature. In spite of the arguments applied by the powerful banking lobby, the Government would certainly have instituted a clearing system in 1934 and 1938 if negotiations with Germany had failed to secure adequate protection of the interests of traders and bondholders. It is even doubtful whether the bankers themselves should be viewed as an homogenous interest group. As the conflict of opinion between the clearing banks and the acceptance houses shows, there was, from 1937,

anything but unanimity as to the wisdom of maintaining credits in Germany. Bankers were unable to extract any clear commitment from the Government to recognise the special position of the Standstill, however sympathetic the Treasury might have been to these creditors.

Thus the London banks had to choose between reducing their credit lines at a considerable cost, or trusting that eventually the politico-economic situation in Germany would improve. They chose the latter course, largely because of the special relationship which they believed existed between the two countries in the financial sphere. The friendship between Norman and Schacht appeared to be proof of this condition. With the political demise of the latter, creditors began to realise that Germany did not view the relationship in quite the same way as London. Unfortunately, by then, it was too late for the policy to be changed. But in measuring the balance of political and economic factors which had helped to formulate that policy, the London banks were not alone in failing to give sufficient weight to the factor of National Socialist ideology.

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A Note on Sources.

The archives of the Bank of England and the Midland Bank proved to be invaluable, particularly in constructing the history of the Standstill Agreements. The Neville Chamberlain papers are also a rich source of material (which seems hardly to have been exploited for the purposes of historical research). In terms of government archives, Treasury files appear to contain the most complete record of financial and economic policy-making towards Germany. This, of course, cannot be viewed as the sole criterion by which to judge the relative importance of the government departments involved in a particular area of policy. But in comparing the relevant files of the Board of Trade to those of the Treasury, it is important to bear in mind that Leith-Ross (the official most active in this field) worked mostly through the latter department.

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