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THE BANKING SYSTEM IN THE NAZI MILITARY AND WAR ECONOMY

Under the impact of spreading direct controls of the evolving military economy, the money and banking mechanism was compelled to relinquish the position it had occupied as the nerve center of the traditional capitalist economy. The money and capital market characteristic of that economy had all but disappeared long before the actual outbreak of hostilities, and credit institutions had been shorn of much of their power. In an article published in January 1938,[8] a leading Nazi banker with a great deal of political influence candidly called attention to the change in the position of the banks, and, indirectly, to some of the other changes. "The banks," he wrote, "can hardly decide on their own any longer which services to render to the entire economy. Their opportunities for service depend on the ever-changing requests which are made of them depending upon the general situation in the economy. The more the capital market as well as the entire economic development are regulated and influenced by the central government, the more the use of bank credit and the volume to be used depend upon decisions which the banks cannot influence directly."

The material that follows will show that the change in relationship between government and economic institutions that marked the rest of the Nazi development also characterized the development in money and banking, and that the accumulation and exercise of power by the government left the money and banking institutions with few of their traditional functions and prerogatives.

To the Nazis, preparing for total war, the inherited banking mechanism was inadequate. Instead of leaving to interest rates and the deposit-generating decisions of the banking system the determination of the volume of funds available for short- and long-term use, the German government saw to it that the Central Bank and other credit institutions provided whatever funds were considered necessary. Instead of permitting the market mechanism to set interest rates, the government fixed them in terms of its politico-military requirements. Instead of depending upon the mechanism of the market for the allocation of funds, the government used special devices to syphon accumulated funds into desired channels.

[8] Friedrich Reinhart, "Bankgewerbe vor neuen Aufgaben," *Bank-Archiv* (January 1, 1938) pp. 137 ff.

Direct controls made new private investment through the capital market either completely impossible or subject to government approval. Credit institutions in the capital market found their status completely altered. Instead of making important investment decisions, and determining the use to which their funds were to be put, they merely had to provide the technical facilities for covering government expenditure or financing new investment, the volume and composition of which had been previously settled by the government. Institutions in the money market did not fare much better. There the banks may have retained a little more authority, but the changes in their prerogatives and limitations upon their authority were drastic.

In neither the money nor the capital market did interest rates, anticipated profits or the entrepreneurial judgment of the individual industrialists and bankers have much to do with investment decisions. It was the government that determined the volume and composition of new capital investment and production, that allocated the raw materials and labor necessary for the execution of the investment and production plans, that became increasingly responsible for the quantity and distribution of industrial and agricultural production — and all with an eye to the requirements of its military program. With such a government, sufficiently powerful and willing to determine not only the amount of credit to be made available to the entire economy at any given time but also the types of borrowers and terms of credit, the meaning and significance of credit control as it was known in the past underwent a profound change, a change affecting both its techniques and its objectives.

The changes in technique introduced by the Nazis were clearly designed to make credit control more direct and qualitative than ever before, and thereby more selective and effective. The pre-Nazi Reichsbank was converted into an institution able to determine, at the behest of the government, not only the total volume of credit to be supplied, but also the use to be made of it. Just as radical was the change in the objectives of credit control. For a long time, credit control was largely synonymous with credit restriction. A primary objective of credit control was the maintenance of the gold standard, or, in the case of a country operating on an inconvertible paper standard, the maintenance of a certain relationship between the domestic currency and foreign currencies.

Given these objectives, both standards tied the domestic currency to other currencies in the international money market and made it difficult for monetary authorities to pursue a wholly independent credit policy that would fit the needs of their domestic situation. The abandonment of the gold standard in 1931, and the subsequent development of a highly effective system of foreign exchange control, enabled the Nazis, on the one hand, to establish any relationship they might have desired between foreign currencies and the mark, and on the other hand, to pursue any kind of domestic credit policy without fear that external forces might upset that relationship.

The abolition of the so-called automatic link between the German currency and the currencies of the rest of the world removed a host of real and imaginary barriers to credit expansion and facilitated a change in the objectives of credit policy. This is implicit in statements of Dr. Schacht, the President of the Reichsbank, and of Hitler himself. If anybody in pre-Nazi Germany was acutely conscious of a relationship between credit policy and the problem of maintaining a stable currency, it was Dr. Schacht. Yet once the Nazis were in control, Dr. Schacht, who had constantly warned pre-Nazi governments against many socially significant measures as endangering the stability of the mark, now publicly called attention to the fact that there were *no* quantitative limits to credit expansion, limits which he had formerly so strongly emphasized. Before the annual shareholders' meeting of the Reichsbank on March 9, 1934, Schacht, then its President, announced that "quantity is hardly a problem in making credit available as long as the credit-standing of the debtor, that is, his ability to make efficient use of the borrowed funds, is carefully considered."[4] An officially authorized text quotes him as declaring to an American journalist a few months later that "expansion of credit is possible as long as there is certainty that the debtors can repay the loans. As long as this principle is observed, there is no limit whatsoever to the increase in credit. Banking policy in Germany intends to give credit to everyone who deserves it."[5] Since the chief borrower was the Reich, which Schacht ostensively felt was making efficient use of the funds it borrowed, there was practically no financial limit to the creation of credit.

Hitler's statement, coming three years later when the economy was a good deal closer to full employment, was drafted more care-

fully. It made clear that the sole yardstick for German credit policy was the relationship between the volume of credit and the potential volume of goods and services to be produced. In an address on December 30, 1937,[6] Hitler declared: "To save our people is not a financial problem, but merely a problem of how to make use of our manpower and our natural resources."

Put positively, the objective of credit control under the Nazis was to provide the financial instruments required to keep the economy fully employed, by combining manpower and natural resources n accordance with the government's military plans. From the very beginning the Nazis realized that their grandiose hopes of military supremacy would require huge quantities of public credit. Their credit and banking measures, therefore, were designed to make the money and capital market as productive of public funds as possible. Despite a system of direct control over production and investment, which made it extremely difficult to use any substantial volume of funds for unapproved purposes, the government took the additional precaution of giving itself legal authority over all credit institutions. This not only enabled it to supervise carefully those banking activities that were still not regulated by the direct controls over the economy, but also ensured full participation by every institution in the military plans of the government.

The significance of the entire Nazi control mechanism in banking can be appreciated only when the totality of their political dictatorship and the military objective of their tightly-organized economy are remembered. Banking legislation was passed when Germany was preparing for war, and the banking and credit system, like so many other parts of the economy, was made an aide-de-camp, a servant of the military master. The Reichsbank Statute was changed, a far-reaching law affecting all other credit institutions was enacted, and various other measures were taken, all of which will be discussed in the following sections. The reader will doubtless realize that some of the new regulations and measures introduced by the Nazis resemble banking provisions that existed in the United States and other countries long before the outbreak of war. It will not be amiss to point out that these similarities are largely of a formal character.

[4] *Schacht in seinen Aeusserungen*, ed. by the Reichsbank (1937) p. 51.
[5] *Ibid.*, pp. 51-52.
[6] *Frankfurter Zeitung* (January 1, 1938).

Foreign Exchange Control

As long as there is freedom in international economic transactions and the various items in the country's balance of payments are cleared through a gold standard system, the Central Bank is obliged to provide for an adjustment of the excess of incoming over outgoing, or outgoing over incoming, payments, by buying or selling gold. This means that the Central Bank cannot completely dominate the credit conditions of the nation. A large excess of outgoing payments may necessitate credit restriction, a heavy excess of incoming payments may lead to an undesirable expansion of credit facilities. Expansion or contraction of credit resulting from the movements of gold may affect domestic prices and production. Changes in the discount rate of the Central Bank may lead to international movements of money and capital that may also affect domestic credit conditions.

With the introduction of foreign exchange control in Germany in 1931, the ties between the German credit mechanism and money and capital markets abroad were severed, and the government was able to prevent those maladjustments in the balance of payments which, under the gold standard, might have affected the credit and price mechanism of the country. Foreign exchange control gave independence to the Central Bank, without which the Nazi government could not have attempted to set up a "self-sufficient" banking system. It meant that excess payments for international transactions would no longer occur unless the government actually wanted them. The power of the government over international economic affairs became so great that it could fix the total amount of outgoing payments at any level it saw fit. It could prevent the amount of outgoing payments from exceeding the amount of incoming payments. Since export trade was not as rigidly controlled as imports, the amount of incoming payments might have exceeded the amount of outgoing payments. The government had no reason to fear such a development since it had no objection to the accumulation of foreign exchange. It had acquired sufficient control over the internal credit mechanism to neutralize the effect of any influx of gold or foreign exchange if it so desired.

Foreign exchange control comprises all measures affecting the collection, administration and utilization of the supply of foreign exchange and gold which becomes currently available. It contains, in addition, all provisions regulating the trade in foreign exchange, including the fixing of the price for foreign currencies in terms of the national monetary standard. It was introduced in Germany before the advent of the Nazi regime, in the summer of 1931, when the spreading credit crisis in Europe drained large quantities of gold and foreign exchange out of the country.

The subsequent history of this control mechanism is not unlike the history of regulation in other parts of the economy. During the first few years every effort was made to maintain as much entrepreneurial freedom as possible. Visible trade was supervised and controlled much less strictly than were capital movements. Emphasis was placed upon quantitative control over the value of imports in order to avoid interfering with the importer's freedom to buy what and from whom he wished so long as he stayed within the quantitative limits set by the foreign exchange authorities. This mechanical system, steadily supplemented by an increased use of individual investigations and permits, was reconstituted as part of the "New Plan" in the autumn of 1934, when it became increasingly necessary to discriminate in favor of essential commodities, particularly raw materials, at the expense of less essential goods. Thereafter, every individual contemplating a transaction which involved an outflow of foreign exchange had to apply to the proper authorities for a permit.

Nazi literature emphasizes that this change was made necessary by an increased shortage of foreign exchange and by the harmful effect upon German trade of the depreciation and devaluation of currencies abroad. This may have been true, but it was scarcely the only reason for tightening the system of control. Basic changes in the rest of the economy made modification of the foreign exchange control mechanism unavoidable. The intricate mechanism of direct control that replaced the previous price system compelled the government to supervise international transactions much more closely. No important changes became necessary in the system of foreign exchange control in all the years after the introduction of the New Plan. The many small changes that were made were concerned with

plugging loopholes and improving administration. The system of control, as it is described here, is embodied in the Foreign Exchange Control Law of December 12, 1938[7] which codified all previous legislative steps, but in no way changed their basic character.

Foreign exchange control was exercised by four different Reich agencies, the Department of Economics, the Reichsbank, the Foreign Exchange Offices, and the Supervisory Agencies. Ultimate authority was vested in the Department of Economics but since problems of foreign exchange and international payments directly affect the work of the Central Bank,[8] the Department of Economics was to work in conjunction with the Reichsbank. Foreign exchange control was subdivided into the collection of all incoming payments in foreign exchange, and the allocation of available foreign exchange for the satisfaction of existing, or the creation of new, obligations. All incoming payments from abroad had to be handed over to the Reichsbank, either directly or through those commercial banks which as agents of the Reichsbank had been designated as "foreign exchange banks" and authorized to deal in foreign funds. To enable the Reichsbank to check up on all payments as they fell due abroad, exporters were forced to record the nature and value of all commodities shipped out of the country. Those who failed either to declare their exports or to deliver their foreign exchange faced severe penalties.

The allocation of foreign exchange was in the hands of 31 Supervisory Agencies and 29 Foreign Exchange Offices. After the introduction of special permits for each individual import transaction, the Supervisory Agencies were by far the more important institutions. They had authority over all visible trade, deciding whether given imports and exports were desirable and whether the quantities, prices, credit terms, or countries involved were satisfactory.[9] Organized by commodities or groups of commodities instead of geographical districts, the Supervisory Agencies were able to acquire a tremendous amount of knowledge and information regarding their specific branches of the economy. The work of the Supervisory Agencies was not limited to regulating visible trade, but was even-

[7] *Reichsgesetzblatt* (1938) I, pp. 1733, 1851.

[8] Carl Hermann Müller, *Grundriss der Devisenbewirtschaftung* (1938) p. 193.

tually extended to controlling all processes of production in all industries. Although the Foreign Exchange Offices that were affiliated with the Regional Collectors of Internal Revenue were subsidiaries of the Department of Economics, they were headed by a Reichsbank official. They were responsible for international trade in "services," for the establishment of Aski-accounts,[10] for all payments resulting from in-transit trade, and for all international money and capital movements except the standstill agreements, the year-to-year arrangements with foreign creditors of short-term debts which were handled by the Reichsbank itself.

With the passage of time, foreign exchange control, as elaborated by those various official agencies, became increasingly complicated, with far-reaching consequences for the conduct of international economic affairs. No longer were economic transactions between Germany and the outside world dominated by the autonomous price mechanism; they were now determined by government agencies interested in the requirements of the military economy. With the extension of foreign exchange control over all transactions in the economy which might lead to a movement of funds across the border, much of the former activity of private banks became subject to close government scrutiny. Dealings in foreign exchange, foreign securities, foreign commercial bills, and foreign real estate, direct investments in foreign countries, loans to foreigners, deposits and withdrawals by foreigners, all these and a host of other customary banking transactions were now carefully controlled. At the same time, the old relationships between German and foreign businessmen were superseded by novel arrangements improvised for special purposes, arrangements like the standstill agreements, the clearing agreements, the blocked marks, the Aski-accounts, etc.

The Reichsbank

Since the Reichsbank was the heart of the money and banking system, and since heavy financial demands were about to be made upon the economy, the Nazi government considered it necessary at

[9] The actual movement of goods was supervised by the customs offices on the basis of the permits issued by the Supervisory Agencies.

[10] Aski-accounts resulted from payments made by German importers for special kinds of imports. Balances in Aski-accounts could be used only for purchase and export of a limited number of German commodities.

an early date of its regime to revise the Reichsbank Act.[11] The government obtained full *legal* control over the Reichsbank by invoking the "leadership principle" according to which the Reich President (synonymous, after August 1934, with Reich Chancellor) was given authority to appoint the President of the Reichsbank and the members of the Board of Directors. Other changes were made in order to erect a *legal* foundation for the huge expansion of public credit that was soon to develop. The power of the Reichsbank to influence the expansion and contraction of credit was made more effective by conferring upon it the privilege of pursuing open-market policies, a change made "in view of the needs of the prevailing new general conditions." [12] Securities thus purchased, as well as outstanding lombard loans (loans against securities), could henceforth be substituted for the commercial bills that before were subsidiary to gold and foreign exchange as legal cover against note circulation. Furthermore, the statutory reserve of 40 percent in gold and foreign exchange originally required against circulating notes, and previously temporarily suspended, was now permanently abandoned. This meant that while technically a gold and foreign exchange reserve requirement was still on the statute books, there was no provision for any minimum percentage. These amendments were the beginning of a development that was carried to extremes in the next six years of Nazi rule. With foreign exchange and gold cover practically not necessary any longer, with commercial bills, outstanding lombard loans, and any securities that the Reichsbank decided to buy, all acceptable as cover, with foreign exchange control preventing disequilibria in the balance of payments, any and every increase in the circulating medium (currency and deposits) could easily be effected.

The Reichsbank Act was again revised in 1937. A law of February 10, 1937 [13] reestablished complete sovereignty of the Reich over the Reichsbank,[14] and made the President and the Board of Directors of the Reichsbank immediately responsible to the Reich

11 Law Concerning the Change of the Banking Act of October 27, 1933, *Reichs gesetzblatt* (1933) II, p. 827.

12 *Verwaltungsbericht der Reichsbank für das Jahr 1933* (1934) p. 8.

13 *Reichsgesetzblatt* (1937) II, p. 47.

14 By a proclamation of the Reich Chancellor on January 30, 1937, the Reichsbank was declared free of all international restrictions still in force from previous reparation settlements. (*Federal Reserve Bulletin*, May 1937, p. 446.)

Chancellor. Since the government was already exercising what amounted to complete power over the Reichsbank, the practical significance of these changes was small. They exemplify, however, the quest after formal "legality" which has characterized so many Nazi activities.

More than two years later, a new act, the Reichsbank Act of June 15, 1939[15] brought to its logical conclusion the development that started with the first Nazi revision in October 1933. Embodying no major changes in the organization and structure of the Reichsbank, the Act codified and legalized the practices which the Reichsbank had already established. It formally set up the Central Bank as a part of the government apparatus enjoying a status similar to that of other government departments, with its employees virtually becoming civil servants. The Reichsbank "shall be directly responsible to the Führer and Chancellor of the Reich" said section 1 of the new Act. The Reich Chancellor was given legal authority to hire and fire the President and the Directors of the Reichsbank at will, to issue instructions, and to supervise the direction and administration of the bank. But most important for our purposes were the provisions affecting the credit policy of the Reichsbank. The Act of 1939 formally abolished the required cover for notes in circulation, and provided for coverage by commercial bills, Treasury bills, securities purchased in the open market by the Reichsbank, and outstanding lombard loans.

There were thus no legal limits whatsoever to the powers of credit creation of the Reichsbank. It could go so far as to issue currency for the purchase of commercial and Treasury bills and securities, and then treat the bills and securities as cover against the notes with which they had been bought; and there was no limit to its doing so. Nor was there any limit to the amount of working credit that could be granted to the Reich, or to the amount of Treasury bills that could be purchased. "The maximum amount will be determined by the Führer and Chancellor of the Reich," said the Act. As for gold and foreign exchange, their function was completely changed inasmuch as they no longer acted as legal reserves. They could still be "admitted as note cover in addition to the cover mentioned above" and the Reichsbank was to keep its holdings "at such

[15] *Reichsgesetzblatt* (1939) I, p. 1015.

a level as it deemed necessary in order to settle balances with foreign countries and maintain the value of the currency."

Commercial Credit and Banking Institutions

Prior to the 1929 depression, the government had no authority to supervise the commercial banks of Germany. Although some measures of control were introduced in 1931 under the pressure of the banking emergency, comprehensive supervision was not set up until the passage of a new law concerning the entire credit system, the German Credit Act of December 5, 1934.[16] The Act gave the government jurisdiction over *all* credit institutions, except those that were owned by the government (the Reichsbank, the Gold Discount Bank – a subsidiary of the Reichsbank – and the check account system of the Reich Post Offices).

The Act followed a pattern which was characteristic of the Nazi economy. It subjected the banks to complete domination of the government and deprived them of the economic freedom they had previously enjoyed, but it was scrupulously careful to perpetuate the institution of private property in banks. It provided that all banks – except saving banks and credit institutions which had been publicly owned before the advent of the Nazis – were to continue to function as privately-owned institutions. Another aspect of the usual Nazi legislative pattern exemplified by the Credit Act was its deliberate generality. The Act's framework was a series of general rules designed to guide the supervising agencies in administering the Act and controlling the credit system. Very few provisions were specific enough to curtail seriously the discretionary powers of the governing bodies. The intent obviously was to provide powers broad enough to meet any situation that might arise.

The authority which the government exercised over the credit system was vested in two institutions set up for that specific purpose.[17] They were the Supervisory Board for the Credit System charged with providing general rules and principles, and the Reich Commissioner for the Credit System, responsible for executing the

16 *Ibid.* (1934) I, p. 1203. For complete translation, see *Federal Reserve Bulletin* (January 1935) pp. 30 ff.

17 The credit institutions were also included in a huge government-controlled organization of all industries and were thus subject to Reich authority through yet another mechanism.

general measures of the Supervisory Board, and enjoying privileges and obligations of his own. The Board consisted of seven members, the President and the Vice-President of the Reichsbank, who were its Chairman and Vice-Chairman, respectively, the Under-Secretaries of the Departments of the Treasury, Economics, Agriculture and Interior, and a member appointed by the Chancellor of the Reich. The Reich Commissioner was one of the subsidiary agents of the Department of Economics. Appointed by the Chancellor of the Reich with the advice of the President of the Reichsbank, the Commissioner might attend the meetings of the Board but was not entitled to vote. This limitation was scarcely important, since the Act did not provide for balloting by the Board, unless a decision of the Commissioner was being appealed. In accordance with the "leadership principle," all decisions were made by the Chairman of the Board. If a single member of the Board protested his decision, the Chairman could be overruled by the Reich Cabinet. By appointing the President of the Reichsbank Chairman of the Supervisory Board, the most influential of the supervisory agencies, the Act concentrated great powers in the hands of the Reichsbank. This power was curtailed, however, by a decree of September 15, 1939[18] which abolished the Supervisory Board and transferred its functions to the Department of Economics. The Office of the Reich Commissioner became the Reich Supervisory Office for the Credit System with a President appointed by the Reich Chancellor after consultation with the President of the Reichsbank. Directly responsible to the Department of Economics, the Reich Supervisory Office exercised control over all credit institutions.

The Act was studded with provisions of the most general kind. provisions designed to give legal standing to any and every step taken by government agencies. Probably the most important of these was the section authorizing the Supervisory Board to "issue rules for the conduct of the business of credit institutions." Any provision that is so general obviously offers, like similar blanket provisions written into other Nazi laws, unlimited possibilities. It intended to legalize the huge arbitrary authority subsequently exercised by the government.

Much of the Act was made up of provisions that empowered a government representative to act as the regulatory agent. Interest

[18] *Reichsgesetzblatt* (1939) I, p. 1953.

rates, commissions, fees, and all other business terms were to be fixed by the Commissioner, with the consent of the Reichsbank. The discarding of the existing market mechanism as interest-rate determiner, and the substitution of rates set by the government, was designed to increase the effectiveness of quantitative credit control over what had been possible when the Reichsbank could change directly only its discount and lombard rate.

The quantitative control was considered far from sufficient. In order to supplement other direct control measures in the economy, the government desired qualitative control over all liquid funds. Without being precise, or referring to qualitative control by name, the Act made ample provision for it. Each month credit institutions were required to report to the Reich Commissioner all debtors whose total liabilities to any individual credit institution exceeded one million reichsmarks, a figure that was not very large. If any single borrower had debts to more than one institution, the Reich Commissioner was authorized to notify all of the institutions involved. Under such a procedure, it is obvious that the Commissioner could not only be kept up to date on information that was important for controlling the credit policy of banking institutions, but could insist on being consulted about the advisability of granting the larger loans before they were actually made. Another aid in exercising qualitative control was the provision limiting the loans of any credit institution to any individual borrower to a percentage of its capital, a percentage fixed by the Supervisory Board;[19] any loan exceeding that percentage was to be "reported" to the Commissioner.

These provisions could be used by the government to make it difficult or impossible to finance new investment of any considerable magnitude out of bank credit, at a time when the capital market was virtually closed to new private investment[20] and bank credit often was a last resort. Powerful instruments in their own right, they could always be buttressed by the more general provisions, such as the article permitting the Supervisory Board to "issue rules for the conduct of the business of credit institutions," and the article instructing the Supervisory Board to shape money and banking policy in

[19] On June 24, 1936, the Supervisory Board fixed the percentage at 10-15 percent, depending on the size of credit institutions (*Deutscher Reichsanzeiger*, 1936, No. 149).
[20] See below, pp. 24-26.

accordance with the general interests of the economy. Together they embodied grants of power broad enough to justify almost any degree of qualitative control. It is not possible to say to what extent the Act was used to reinforce the direct controls in the economy, to eliminate a source of funds that might be used for accumulating undesirable inventories, or to prohibit new investment.

The Act not only introduced regulatory provisions which were sorely needed for commercial banking in Germany and which had been long overdue, it also abolished every vestige of freedom of trade for credit institutions. Thus it was possible for the government to ferret out whatever information it might require to enforce its will. A license from the Reich Commissioner was prerequisite to opening a new credit institution or establishing a branch office at home or abroad. Any credit institution or any of its branches could be closed by the Commissioner for "the violation of general interests," a provision general enough to give the authorities unlimited power. Credit institutions had to keep the Commissioner informed concerning various changes in their circumstance, such as changes in management, changes in the capital structure, or a decision to close the institution. The Commissioner could request balance sheets, profit-and-loss accounts, and any books or documents of the institution. He could attend shareholders' and partnership meetings and could request that shareholders' and membership meetings be called so that problems of one kind or another could be brought before them. To these provisions should be added the many sections of the Act which permitted complete insight into internal affairs and business practices of all credit institutions, and those sections that made the imposition of heavy penalties possible. From a superficial point of view, some of these new regulations may be compared to similar provisions in the United States. But seen as a deliberately planned whole and in the political and economic structure of Nazi-Germany, they constituted a formidable barrier both against concealment and non-cooperation in the military economy.

The other provisions of the Act were concerned largely with the future condition of the capital market, which the Nazis were preparing to exploit to the utmost as an aid in financing their gigantic military program. According to a competent authority who wrote soon after the passage of the Act,[21] the provision for government

[21] *Das Reichsgesetz über das Kreditwesen*, ed. by *Frankfurter Zeitung* (1935) p. 70.

fixed-interest rates was largely inspired by the government's interest in future developments in the capital market. A competitive market might have established higher interest rates than the government desired. But more important in connection with the capital market were the parts of the Act specifically designed to make funds available for government expenditure. Such were the provisions requiring credit institutions to keep, besides a cash reserve, "secondary" reserves in commercial bills and securities, and limiting their holdings in equity, real estate, and permanent business participations. The Supervisory Board was to determine how large a percentage of a bank's liabilities (except savings accounts) were to be kept as a secondary reserve. The percentage to be fixed by the Board could not exceed 30 percent. No doubt this provision for secondary reserves was primarily designed to induce credit institutions to buy government securities. The Supervisory Agencies, moreover, were in a position to exercise moral suasion. It is reported, for example, that the Board, acting on the basis of its detailed knowledge of the balances carried by each depositor, instructed credit institutions to "invite customers with balances of more than 5,000 reichsmarks to subscribe to government issues." [22]

A word should be said about savings banks, a source of government credit about which the Act was not very specific, merely delegating to the Supervisory Board the power to issue instructions concerning reserve requirements and investments. There is no doubt that from the very beginning[23] the government planned to have savings banks invest a large part of their funds, as they later did, in government securities.

SPECIAL MEASURES AFFECTING THE CAPITAL MARKET

It did not take the Nazi government long to realize that its ambitious plans required the piling up of huge government deficits, much of which would have to be financed in the capital market. With this in mind the government reached into the capital market and through a series of legislative and administrative steps soon altered its function and significance. Mention has already been made of the Credit

[22] A. Dauphin-Meunier, "Le Contrôle des Banques en Allemagne," *Revue d'Economie Politique* (1936) p. 418.

[23] *Das Reichsgesetz über das Kreditwesen* (previously cited) p. 68.

Act provisions designed to harness the capital market to the needs of the military economy. We refer particularly to the provisions making it obligatory for all credit institutions to hold a certain portion of their assets in the form of commercial bills and securities,[24] provisions which radically changed the pre-Nazi practice of German commercial banks, savings banks, insurance companies, etc., of investing relatively small amounts of their funds in government securities. From official statistics,[25] it would seem that the investment policies of savings banks and insurance companies were immediately affected, investments in government issues growing rapidly while investments in mortgages, individual loans, etc., declined. The change in the portfolios of commercial banks, particularly with regard to long-term government issues, was effected much more slowly, but the pace quickened visibly in the two years before the outbreak of war.

The provisions of the Credit Act, however, were only a fragment of the government's activity in the capital market. Many other steps were taken to "increase the internal strength" of the capital market and improve its ability to absorb government loans. Some of these, such as the Law of June 1, 1933 reducing interest rates on agricultural debts, the Law of September 21, 1933 consolidating the short-term municipal debt, and the various decrees extending the moratorium on mortgages and other debts,[26] were primarily concerned with the creditor-debtor relation. Other steps, such as the various conversion laws, were adopted in order to lower interest rates that might otherwise have tempted capital away from government issues, or increased the government's cost of borrowing. Many of these, as well as relevant changes in tax legislation, are described later. Here, two other measures will be treated. One of them was concerned primarily with the stock market and probably affected the capital market only indirectly. The other represented a major effort by the Nazis to link the capital market directly to their military program.

Before the Nazi victory in 1933 the stock market had been a

[24] Although this provision made no specific reference to government securities, it was used to increase the amount of government paper held by credit institutions.

[25] Reichs-Kredit-Gesellschaft, *Economic Conditions in Germany in the Middle of the Year 1939*, pp. 52-53.

[26] *Reichsgesetzblatt* (1933) I, pp. 331, 647, 1092; (1934) I, p. 1255; and (1935) I, p. 1467.

favorite target of Nazi propagandists. But once they were in control, they contented themselves with minor organizational changes, such as reducing the number of stock exchanges from twenty-one to nine. Due to the improvement in general business conditions, and possibly to the fears of investors that inflationary movements might develop, stock market prices had been rising steadily since early in 1933. From 1933 to 1934 the average of stock prices rose approximately 15 percent; from 1934 to 1935, approximately 17 percent.[27] Dividends on stocks were increasing at the same time as the yield on long-term bonds was declining. Claiming that it feared a possible diversion of funds into the stock market, the government in December 1934 added to its public warnings against speculative tendencies and to its pressure upon the banks to discourage undesirable stock market practices, the law concerning the distribution of profits by corporations.[28]

This law made it illegal for corporations with a capital of over 100,000 reichsmarks to distribute, in cash, dividends exceeding 6 percent (in some cases 8 percent) of the par value of the stock. The difference between the permissible cash dividends and the declared dividend (if it was higher than permissible) was to be paid to the Gold Discount Bank, which was instructed to invest this in government bonds to the account of the shareholders of the corporation. After three years, when the law expired (at the end of 1937) the funds accumulated in the Gold Discount Bank were to be distributed to the shareholders in either cash or securities. But in December 1937 the law was extended for another three years,[29] and it was decided to distribute the funds of the first three years in tax certificates acceptable in payment of many Federal taxes to be levied between 1941 and 1945. Finally, in June 1941, the law was again modified.[30] This time, any new increase in dividends was prohibited unless a corporation had paid less than 6 percent before the issuance of the decree. Dividends of all corporations in excess of 6 percent were subject to a sharply graduated tax, heavy enough to make dividends in

27 *Vierteljahrshefte zur Konjunkturforschung*, Vol. 9, No. 3, Part B, p. 284; and Vol. 11, No. 4, Part B, p. 112.

28 *Reichsgesetzblatt* (1934) I, p. 1222.

29 *Ibid.* (1937) I, p. 1340.

30 *Ibid.* (1941) I, pp. 323, 493.

excess of 6 percent virtually impossible.[31] The portion of the declared dividend which exceeded 6 percent (in some cases 8 percent) and could not be paid out in cash was no longer to be turned over to the Gold Discount Bank, but to be invested by the corporation in government securities and held in trust for the shareholders.[32]

It has often been claimed that the law, in keeping with principles frequently proclaimed by the Nazi party, genuinely sought a reduction in dividends, or that its major concern was the amassing of large quantities of funds for the purchase of government bonds. Neither claim stands up under careful scrutiny. In the first place, corporations could legally escape the provisions of the laws of 1934 and 1937 by increasing the par value of their shares. The par value of any share could be so increased that any absolute dividend payment would amount to a yield of not more than 6 or 8 percent of the par value. A good many corporations made use of this device until it was modified in the 1941 amendment. After the 1941 amendment, a corporation could no longer escape the maximum provision of the law by changing the par value of shares. But the decree expressly made it possible for corporations to escape the new heavy tax on dividends in excess of 6 percent by modifying their capital structure. As a matter of fact, the government did everything in its power to encourage such reorganizations of corporations.[33] Several hundred corporations "rectified" their capital structure within six months after the release of the decree,[34] which meant that they escaped the penalty tax in paying dividends in excess of 6 percent.

Second, it is clear that shareholders were not permanently deprived of the increased earnings of their companies. They were merely compelled to wait a few years before cashing in on them.

[31] If a corporation paid a dividend of 7 percent, it was to pay an additional ½ percent of the par value of the share as tax; with an 8 percent dividend a tax of 2 percent; with a 9 percent dividend a tax of 7.5 percent; and with a 10 percent dividend a tax of 12 percent was to be paid. This meant that if a corporation wanted to distribute a dividend of 10 percent – of which 2 or 4 percent was to be invested in government securities – it actually had to pay out 22 percent.

[32] For a detailed discussion of the June 1941 decree, see *Foreign Commerce Weekly* (August 16, 1941) pp. 6 and 19; and Friedrich Sarow, "Dividendenbegrenzung und Kapitalsausgleich," *Die Wirtschaftskurve*, Vol. 20 (1941) I, p. 187.

[33] Heinrich Strathus, "Das neue Dividendenbild," *Die Deutsche Volkswirtschaft* (1941) p. 675.

[34] *Wirtschaftsdienst* (1942) p. 33.

Third, corporations could avoid contributing to the purchase of government bonds by the simple expedient of keeping their dividends within the limits of the law. The resulting accumulation of undistributed profits would have enabled them to finance expansion of capacity out of their own funds, an effect that the government ardently desired. Since, as will be explained below, the government was determined to reserve the capital market for itself, it hoped to decrease the demand by corporations for outside funds by encouraging them to retain their earnings.

There can be no doubt that the law had little direct effect upon the government bond market. The total sum paid into the Gold Discount Bank under the law amounted to 103 million reichsmarks for the period of the first Act until the end of 1937, and to 108 million reichsmarks for the second period, until the middle of 1941[35] – both very insignificant amounts. Any important effects that the law may have had must have been indirect. By inducing some corporations to accumulate more funds than they otherwise would, it may have reduced the pressure on the capital market and reduced somewhat the purchasing power in the hands of shareholders. If, in addition, we consider the fact that not every corporation evaded the law, it becomes apparent that the law placed a damper on the price of stocks insofar as shareholders of non-evading corporations realized that they could not cash in on their earnings for some time to come, and insofar as the dividends of such corporations were kept below what their earnings would ordinarily have warranted. Average stock prices increased about 10 percent from 1935 to 1936 and about the same percentage from 1936 to 1937. After 1937 stock prices declined until the outbreak of war by about 10 percent.[36]

Finally, by curtailing speculation in stocks with a stable par value and by hiding speculation in stocks with par values that were changed behind a facade of comparatively stable stock prices, the law probably prevented any large-scale movement into the stock market by the general public; the public might otherwise have been tempted by continually rising stock quotations to withdraw funds from the

[35] Martin Lohmann, "Die Dividendenabgabeverordnung im Rahmen der Kriegswirtschaftspolitik," *Jahrbücher für Nationalökonomie und Statistik* (1942) p. 64.

[36] *Statistik des In- und Auslandes,* Vol. 14, No. 2, p. 38.

bond market for the purchase of stocks.[37] After the outbreak of war, however, indirect measures were no longer able to forestall a boom in the stock market. Powerful forces led to it — the increasing liquidity in the economy, the optimism generated by military successes, the growing difficulty of finding outlets for the purchasing power in the hands of the public, the favorable business conditions, etc. In about two years, from the beginning of the war until the fall of 1941, average stock prices rose by about 50 percent.

It was then that the government stepped in and destroyed the last relatively free market in the economy.[38] Loans for the purchase of stocks were prohibited. Shareholders had to file a declaration with the government of all shares purchased since the outbreak of war if their market value exceeded 100,000 reichsmarks. The government could, at any time, request that any of these shares be delivered to it for cash and that the proceeds be invested in securities to be specified by the government. In the summer of 1942, the government started to make use of that authority. It was hoped that the possibility of forced sales would discourage speculators and that the government could accumulate a pool of securities to be thrown on the market whenever the market price of such securities tended to move upward. Although prices were not kept stable, the rising tendency seems to have been checked somewhat. Average stock prices at the end of 1942 were about 5 percent higher than a year before.[39]

Long before the passage of the law concerning the distribution of profits, the Nazi government had taken a more important step calculated to affect the capital market directly. It had drastically limited the flotation of new private capital issues, a move made in anticipation of subsequent developments in the economy. During the next two years the improved prospects for new investment and the decline of long-term interest rates prompted private entrepreneurs to seek new funds. The consolidation of short-term debts, and the

[37] Another measure, which may have slightly favored the bond market at the expense of the stock market, was the provision affecting stock market transactions of foreigners. They could use any blocked balances for the purchase of bonds but in purchasing stocks were restricted to blocked balances that had their source in a stock transaction (Friedrich Müller, "Reichsbank und Kapitalmarkt," *Schriftenreihe der Staatsbank*, Vol. I, p. 132).

[38] *Wochenbericht des Deutschen Instituts für Wirtschaftsforschung* (1942) p. 37.

[39] *Wirtschaft und Statistik* (1943) p. 106.

reduction of the interest burden of states, municipalities, and other debtors placed some of them in a position to increase their borrowing. It was essential, therefore, that as many of them as possible be denied access to the capital market, not only because the government needed all available long-term funds for its own military purposes, but also because the inability of private enterprise to obtain capital for new investment would stimulate its efforts for self-financing.[40]

To limit the flotation of private issues, a special committee was appointed which was to examine each prospective capital issue on its own merits.[41] This committee, established by administrative action on May 31, 1933, with the President of the Reichsbank as chairman, was granted "complete authority on its own to decide upon and supervise all matters pertaining to the money-and-capital market lest disturbances of the money-and-capital market occur because of decisions or interferences by agencies without authority."[42] There is little information on the actual activities of the committee. From the little there is, it seems unlikely that it exercised the sweeping authority suggested by the vague language of the official statement just quoted. The committee was there to protect the capital market from demands that might disturb the financial policies of the government.

Since technical responsibility for granting permission to float new securities rested with the Department of Economics, the functions of the committee must have revolved about the making of recommendations to this Department. During the first few years of Nazi rule the number and size of private issues was exceedingly small.[43] Beginning with 1936, there was a sharp increase, the committee having ruled that financial requirements of various industries under

40 The government seems to have been successful in that attempt. It is reported that the amount taken for depreciation increased considerably in these years and that the percentage of total profits paid out for dividends declined. While according to an estimate by the Reich Statistical Office, total dividends of all corporations were almost as large as their depreciations in 1927, they declined to little more than ⅓ in 1938 (*Die Deutsche Volkswirtschaft*, 1941, pp. 840-41).

41 Friedrich Müller, *op. cit.*, p. 131.

42 *Wochenbericht des Instituts für Konjunkturforschung* (March 23, 1938) p. 95.

43 The Institute for Business Cycle Research published interesting information in this respect. It compared the period 1926 to 1929 with the period 1932 to 1936. The relationship between new public and private issues during the first period was .55 to 1; in the latter period, 5.5 to 1 (*ibid.*, January 27, 1937, p. 20).

the Four Year Plan could be satisfied in the capital market. In the six years from 1933 through 1938, over 17 billion reichsmarks of new loans were floated in the capital market, of which 2.5 billion reichsmarks or about 15 percent were private issues. Of these private issues, 1.5 billion or 60 percent were offered in 1937 and 1938.[44] Applications were approved for a few selected purposes, several issues for individual states, some mortgage bonds, and some industrial loans, necessary for financing certain projects under the Four Year Plan. Since the projects under the Four Year Plan were undertaken at the behest of the government, for military purposes, the use of the capital market to finance them is actually an example of the reservation of the capital market for government use.[45]

Various indications exist that after the outbreak of war, the government permitted even more private issues to be floated in the capital market. With the progress of the war, there was a growing need on the part of private firms to resort to the capital market to finance their new investment, and at the same time their ability for self-financing declined because of higher corporation taxes, sharper price control, regulation of profits, etc.[46] The total amount of private issues floated in the capital market was estimated officially at just over 6 billion reichsmarks for the period 1933 to the beginning of 1942.[47] If this be compared with the previously mentioned estimate for 1933 to 1938, it would seem that almost 4 billion reichsmarks of private issues were offered to the public in the three years 1939, 1940, and 1941.

[44] Reichs-Kredit-Gesellschaft, *op. cit.*, p. 52.

[45] To round out the picture mention might be made of a measure that played an auxiliary role in reserving the capital market for government use. A provision of the Law of September 21, 1933 (*Reichsgesetzblatt*, 1933, p. 647) forbidding municipalities to incur any short-term debts for two years after the passage of the Law appears to have been designed for their own protection. But this restriction was eventually extended to become part of the general plan to reserve the capital market. Thus a decree of May 5, 1936 (*ibid.*, 1936, p. 435) kept savings banks and giro banks from making loans to municipalities, and provided that thereafter, current budgets of municipalities include reserves for debt amortization. lest they find themselves without funds when loans mature, and be compelled to resort to the capital market.

[46] *Die Deutsche Volkswirtschaft* (1942) pp. 9-10.

[47] Emil Puhl, "Grundfragen der Deutschen Währungspolitik," *Der Deutsche Volkswirt* (1942) p. 1510.