

## The Schacht and the Keynes Plans

When in April 1943 the British Chancellor of the Exchequer presented to Parliament his proposals for an International Clearing Union, drafted by J.M. Keynes and later to become known as the "Keynes Plan", he stated that "the particular proposals set forth below lay no claim to originality".

In war time Britain there was, understandably, no cause to suggest to Parliament and to the world at large that the concept of a clearing union was of German origin, all the more since the German originator was no other than Dr. Schacht, whom public opinion in the United Kingdom and elsewhere held responsible for Germany's preparations for war, or at least for its power to wage war. Nonetheless, this was the case.

In his book *76 Years of my Life* published in German in 1953, Schacht recalls a conversation with Owen Young, Chairman of the Young Committee in Paris in 1929-30, during which he had set out his "master plan" for entrusting the future Bank for International Settlements with the function of granting loans to underdeveloped countries. Schacht had also given Owen Young a typewritten copy of the plan, which Young passed on to Shepard Morgan, economic adviser to the Committee, who kept it in his personal archive. Shepard Morgan himself gave it to the author of the present article in 1953 on the occasion of a discussion concerning the Young Plan.

The story goes back to the beginning of 1929, when an international conference was arranged with a view to replacing the Dawes Plan of 1924 by a new plan which would, above all, finally settle the problem of German reparation payments.

The Dawes Committee, which had laid down the annual reparation payments to be made by Germany for an unlimited period, had been a committee of international experts, whereas the Young Committee of 1929 was a "political" committee: in the words of the British delegate, Sir Josiah Stamp, when receiving Dr. Schacht on his arrival to the Paris conference: "Dr. Schacht, this is a political conference". Moreover, the Dawes Committee had had a different task, as Sir Josiah Stamp pointed

out in his report on the subject of "Reparation Payments and Future International Trade" for the International Chamber of Commerce in Paris in May 1925: "It cannot be too clearly understood, however, that the reparations as such were not strictly the business of the Dawes Committee at all. Their task was to make proposals for stabilising the German currency and balancing the German budget".

Obviously, this task could not be accomplished without some reference to the reparations question, for confidence in the German currency could not be restored unless the political demands to be met were established for at least some years ahead, nor could the budget be balanced unless the amounts to be raised internally to meet these demands were known. But the fundamental question of stabilising the currency and balancing the budget came before that of reparations and not the other way round. This confronted the experts with a very difficult problem, because it created a conflict between fundamental economic experience and political demands.

The fundamental economic experience of the experts was summed up by the leader of the American delegation, Rufus Dawes, in his book *The Dawes Plan in the Making*: "It was generally agreed that a sound and stable currency was the first thing required for a stabilised Europe. It was equally certain that a sound and stable currency was impossible until the several governments had found ways and means to live within their income. For no independent nation yet has been able long to indulge in expenditures beyond its actual income without inflating its currency".

International economic experts had been faced with this problem before, in particular within the Financial Committee of the League of Nations, when it arose in connection with Hungarian reparations. It was thanks to the British economist Sir Arthur (later Lord) Salter, head of the Economic Division of the League of Nations, and his assistant Per Jacobsson, who became Economic Adviser of the BIS for 25 years and then Managing Director of IMF, that a compromise was found by inserting a so-called "Transfer Clause" into the Hungarian reparation obligations. This also served the experts of the Dawes Committee. They stated that "there has been a tendency in the past to confuse two distinct though related questions, i.e. first, the amount of revenue which Germany can raise for reparation account, and, second, the amount which can be transferred to foreign countries. The funds raised and transferred to the Allies on reparation account cannot, in the long run, exceed the sums which the balance of payments makes it possible to

transfer, without currency and budget instability ensuing. But it is quite obvious that the amount of budget surplus which can be raised by taxation is not limited by the entirely distinct question of the conditions of external transfer. We propose to distinguish strongly between the two problems, and first deal with the problem of the maximum budget surplus and afterwards with the problem of payment to the Allies".

In 1925, in his report for the International Chamber of Commerce in Paris, Sir Josiah Stamp emphasised: "The critical figure to be fixed was the amount that could be afforded out of German industry and taxation as a maximum, in all probable circumstances within Germany. The amount capable of being exported would obviously not, in any case, be larger than this, but might in some circumstances, incapable of forecast, be compelled to be much less".

The report of the Dawes Committee stated quite clearly: "The extent to which economic adaptation is possible over a long period of years, under the pressure of external obligations, is a matter of conjecture; an existing economic balance, before such obligations have been in operation long enough to have their effect on the economy of the country, gives a very uncertain criterion. The economic balance is, therefore, by comparison with the budget, incapable of close calculation, "unmanageable" and too elastic.

But the limits set by the economic balance, if impossible of exact determination, are real. For the stability of a country's currency to be permanently maintained, not only must her budget be balanced, but her earnings from abroad must be equal to the payments she must make abroad, including not only goods she imports, but the sums paid in reparation. Nor can the balance of the budget itself be permanently maintained except on the same conditions. Loan operations may disguise the position — or postpone its practical results — but they cannot alter it. If reparation can, and must, be provided by means of the inclusion of an item in the budget, i.e. by the collection of taxes in excess of internal expenditure, it can only be paid abroad by means of an economic surplus in the country's activities".

It was envisaged that in the event of the reparation amounts exceeding the transfer amounts, they should be accumulated up to a maximum of 2 billion Reichsmark and put at the disposal of the Reichsbank for its short-term money operations. However, in the annex to the Plan it was stipulated that such short-term operations should be left to the Transfer Committee and not to the Reichsbank. In the event of a further accumulation, investment in long-term bonds was compul-

sory, up to an amount of 5 billion Reichsmark. For the duration of the Dawes Plan, i.e. from 1st September 1924 to 31st August 1929, total reparation payments were fixed at 7,970 billion Gold Marks, of which 4,061 billion was to be raised within the budget and 3,809 billion outside the budget.

According to the official figures, the German budgets recorded a surplus of 1,070 billion Reichsmark during this period. However, the German Ministry of Finance was deceiving itself and the reparation Agent, for in fact there was an overall deficit of 1,284 billion Reichsmark, which the German Government officially acknowledged in August 1930.

Not unrelated to this budget deficit was the balance of trade, which from 1924-29 showed a deficit of 7,782 billion Reichsmark. As a result of the surplus on services account, the current account showed a deficit during this period of 6,213 billion Reichsmark.

On 22nd August 1928 the German Government decided to open negotiations with the Allies in order to achieve two objectives, namely a final settlement of the reparations question and, at the same time, an early termination of the allied occupation of the Rhineland. In final discussions between Poincaré and Stresemann on 27th August 1928, Poincaré made it clear that, as far as France was concerned, the two objectives were linked, in other words, that there was no question of an early termination of the occupation unless the French reparation claims were met. The extent of these claims was easily calculable, corresponding to cover for France's debts to the United States plus a "surplus" for France (the so-called "indemnité nette"). Thus, the German Government knew in advance both that the reparation question had to be settled first and at what price.

Schacht was unaware of this background, but was faced with the fact that the forthcoming conference was to be a political one and that the German Government was willing to pay the price for a solution. As head of the German delegation Schacht had only one possible objective: to reduce the amount of reparations to be paid by Germany by applying economic common sense and to establish machinery that would make the payments possible. As President of the Reichsbank (1924-30) he was certainly aware of the country's trade deficits and budget deficits, as evidenced by his permanent confrontation with the German Ministers of Finance. He also knew of Germany's foreign borrowing, which he had already tried to stop in 1927. As the German negotiator at the Dawes Conference he also knew about the transfer

problem and the view of the Dawes experts that "loan operations may disguise the position but cannot alter it". Thus, he was fully aware that a transfer of funds during the period of the Dawes Plan was — on the basis envisaged by the experts — not feasible. However, he could not have stopped it, since the transfer was in the hands of the Transfer Committee, of which the Reparation Agent himself was the Chairman. Nor could he refuse the transfer, since it was obvious from the Reichsbank's statements how much foreign exchange it held.

Schacht certainly knew of the connection between the foreign credits to Germany and the transfer of reparation payments, as he admitted to Owen Young at the beginning of the Conference on the Young Plan. In his conversation with Owen Young he also pointed out that before the war the United Kingdom, France and Germany had provided the underdeveloped countries in South America, the Balkans and elsewhere with loans, while they themselves did not need foreign credits. In order to help Germany, impoverished by the war, to fulfil its reparation obligations, the Allies should now make loans to the underdeveloped countries, to enable them to buy industrial goods from Germany. It would be of no benefit to have Germany compete with the other European industrial countries on the existing world market. Such competition had been one of the fundamental causes of the ending of world peace and the war. A repetition of such competition should be avoided, or at least mitigated, by creating new markets open to all industrial countries. Increasing the welfare of all peoples was the economic principle that would maintain peace and avoid wars.

In order to make this possible, Schacht proposed the following scheme:

*Draft Regulation of the Clearing House.* The following Banks of Issue have agreed to found a Clearing House, being a private and independent corporation in accordance with the legislation of the country where it will have its domicile:

The Reichsbank, Berlin;

The Bank of England, London;

The Banque Nationale de Belgique, Brussels;

The Federal Reserve Bank of New York, New York;

The Banque de France, Paris;

The Banca d'Italia, Rome;

The Bank of Japan, Tokyo.

### *I Capital*

The German Government shall deposit with the Clearing House bonds made out in gold to the countervalue of 5 billion Gold Marks constituting a direct and unconditional obligation of the German Government. These bonds shall become the property of the Clearing House. The bonds shall not bear interest but shall be redeemed in the course of (X) years by annuities on a decreasing scale. The first annuity shall be paid before the Clearing House commences its activities.

### *II Organisation*

The Clearing House shall be managed by a Board of Directors consisting of the Governors of the member banks or their authorized attorneys.

An advisory board with the name of General Council shall be appointed, consisting of twenty-one persons, of whom three shall be appointed by each member bank.

The members of the Board of Directors and of the General Council shall each have one vote in their respective bodies and decisions shall be taken by majority vote.

### *III Transactions*

The Clearing House shall grant credits on a fine gold basis by opening balances in its books up to a maximum amount of the countervalue of the German gold bonds.

Such credits shall be granted:

- (a) to banks of issue;
- (b) to governments and other public authorities (states, federal states, provinces, municipalities, etc.);

(c) to other borrowers subject to the provision of guarantees by bodies under (b).

Ratio shall be fixed in advance between the total amount of credit granted and:

(i) credit granted under each of the categories (a), (b) and (c); and

(ii) the total outstanding capital and reserve funds of the Clearing House.

Credits passed to somebody's account may only be disposed of in favour of the owners of accounts.

Credit granted shall be repaid by the borrower at maturity by transfer from other accounts or by cash payment in such currencies as specified by the Board of Directors or by payment in gold.

The Clearing House shall not be allowed to engage in acceptance or endorsement business.

### *IV Reserve Fund*

The income of the Clearing House, both from payment of annuities by the German Government and from interest and commission on its regular business, shall be allocated to reserve funds as follows:

- (a) income from annuities, including interest earned on such annuities, to a sinking fund;
- (b) other income to a general reserve fund.

The two reserve funds together shall not exceed the countervalue of 5 billion Gold Marks.

### *V Distribution of Profits*

There shall be no distribution of profits unless and until the reserve funds have reached the ceiling of 5 billion Gold Marks. The Reichsbank shall receive a share (still to be determined) in the capital after the other member banks have received 5 billion Gold Marks in dividends, to be distributed in proportion to their respective shares in the capital of the

Clearing House for the account of their respective governments as follows:

The Bank of England	a %
The Banque Nationale de Belgique	b %
The Federal Reserve Bank of New York	c %
The Banque de France	d %
The Banca d'Italia	e %
The Bank of Japan	f %

### VI Accounts

The Clearing House shall publish a statement of its assets and liabilities as at the end of each month in accordance with the attached schedule. At the close of the year an annual balance sheet and profit and loss account shall be drawn up for submission to those concerned.

At the beginning of the Conference in February 1929 Schacht gave his draft to Owen Young, who passed it on to Shepard Morgan, his economic adviser. A week later Schacht personally gave a slightly revised draft to Shepard Morgan, Randolph Burgess and Walter Stewart, also members of the American delegation. The only differences between the two drafts were that in the second version the "Clearing House" became the "International Settlements Bank" and the bonds were denominated in Reichsmark instead of Gold Marks. This the author learned from Shepard Morgan on the occasion of an interview in January 1955 on the subject of the Young Plan, and it was later confirmed by Burgess and Stewart. Shepard Morgan was then also still in possession of a typewritten copy of Schacht's first draft, which he was kind enough to make available to the author. That is how the Schacht Plan survived.

Just how modern Schacht's ideas were only became apparent after the Second World War. With the depositing of bonds to the value of 5 billion Gold Marks or Reichsmark, the German Government would endow a Clearing House with a capital to enable it to grant book credits to the participating central banks, to governments, states, federal states, provinces and municipalities and to other borrowers with appropriate guarantees. Credit lines would be established in advance in relation to the capital and reserve funds. The most important features were that the

credits were only to be granted in the form of book credits, that repayments would be made either from another account with the same institution or in cash, and that the central banks would be able to utilise the credits they obtained as cover for the respective currencies.

Thus, the German obligations were to be used as a basis for international credit expansion, making it possible to mobilise the claims on Germany up to an amount of 10 billion Gold Marks or Reichsmark (if the reserve funds are included) promptly and without any transfer difficulties, since the transfer could only be effected by transfer from one account to another.

However, one very important clause, which was not contained in the written draft but revealed to the author by Shepard Morgan, was that Germany itself would have no access to Clearing House credits.

Except that a "Bank for International Settlements" was subsequently founded, Schacht's plan was never realised, the reason, as Shepard Morgan pointed out, being precisely this clause. The American delegation saw in it a device on the part of Schacht to expose Germany's neighbour and creditor countries to inflation, by which Germany, the only country unaffected, would correspondingly benefit. This was the same "inflationary" argument which is regarded as being responsible for the failure of the Keynes Plan 14 years later.

When in April 1943 the Chancellor of the Exchequer presented the Keynes Plan to Parliament, he noted that "it is difficult to see how any plan can be successful which does not use these general ideas, which are born of the spirit of the age". The Keynes Plan proposed establishing a currency union, which it called an "International Clearing Union". However, in contrast to Schacht's Clearing House, the Clearing Union would be based not on existing currencies but on newly created international bank-money, called "bancor", fixed in terms of gold.

Along lines similar to those of the Schacht Plan, the central banks of all member states (and also of non-members) would keep accounts with the International Clearing Union, through which they would be entitled to settle their exchange balances with one another at their par value as defined in terms of bancor. Countries having a favourable balance of payments with the rest of the world as a whole would find themselves in possession of a credit account with the Clearing Union, and those having an unfavourable balance would have a debit account. Special measures were envisaged to prevent the piling up of credit and debit balances without limit.

The idea underlying such a Union, the Chancellor explained, was simple, namely to generalise the essential principle of banking as it is exhibited within any closed system: the necessary equality of credits and debits. If no credits could be removed outside the clearing system, but only transferred within it, the Union could never be in any difficulty as regards the honouring of cheques payments drawn upon it.

The capital of the Clearing Union — in contrast to the Schacht Plan — would not consist of deposits in a particular currency, but each member state would have assigned to it a quota which would determine the measure of its responsibility in the management of the Union and of its right to enjoy the credit facilities provided by the Union. The initial quotas might be fixed by reference to the sum of each country's exports and imports on the average of, for example, the three pre-war years at, say, 75% of this amount, with a special assessment being substituted in cases where this formula would be, for any reason, inappropriate. Subsequently, after the elapse of the transitional period, these quotas would be revised annually in accordance with the running average of each country's actual volume of trade in the three preceding years, rising to a five-year average when figures for five post-war years were available.

The member states would agree to accept payment of currency balances, due to them from other members, by a transfer of bancor to their credit in the books of the Union. They would, subject to certain conditions, be entitled to make transfers of bancor to other members which had the effect of overdrawing their own accounts with the Union.

As an inducement towards keeping a level balance, members would be obliged to pay to the Reserve Fund of the Union a charge of 1% per annum on the amount of their average credit or debit balance in bancor in excess of a quarter of their quotas, and a further charge of 1% on their average credit or debit balance in excess of a half of their quotas. Thus, only a country which kept as nearly as possible in a state of international balance on the average of the year, would escape this contribution.

By way of limiting the accumulation of debit balances, no member state would be allowed to increase its debit balance by more than a quarter of its quota within a year without the permission of the Governing Board. If a member's debit balance reached a half of its quota, the Governing Board was entitled to require the deposits of suitable collateral. If the debit balance had exceeded three-quarters of the quota, the Governing Board might, as a final sanction, declare that

the member state was in default and no longer entitled to draw against its account except with permission.

As regards credit balances, the Plan envisaged that if a member state's credit balance had exceeded a half of its quota on the average of at least one year, the member state would have to discuss with the Governing Board what measures would be appropriate to restore the equilibrium of its international balances, including: the expansion of domestic credit and domestic demand; the appreciation of its local currency in terms of bancor or, alternatively, the encouragement of an increase in money rates of earnings; the reduction of tariffs and other discouragements against imports; and international development loans.

No member state would, however, be entitled to demand gold from the Union against a balance of bancor, since such balance was available only for transfers within the Union.

Clearly, the Keynes Plan went far beyond what was conceived by Schacht. Keynes was the first to make a clear distinction between the financing of international trade at short term and the financing of capital movements at long term, which he specifically left to be entrusted to a new, specialised institution, subsequently created in the form of the World Bank. It must, however, be admitted, that at the time of Schacht's plan this distinction was less easy to make. International finance was the financing of trade, the only exception being reparations.

It is true that German reparation payments from 1924 to 1929 had been financed by foreign credits, mostly from the United States. The connection between international trade and international capital movements was based on the common conviction that a capital transfer abroad was only possible out of a surplus in the balance of trade, and since reparation payments were a capital transfer, Schacht's objective was to achieve such a surplus by promoting investment in third countries as possible future markets for German exports.

Keynes, on the other hand, had the experience of the 1931 crisis, when the recalling of credits from abroad not only caused the collapse of the international monetary order of the gold exchange standard, but also forced international trade into the strait-jacket of bilateralism and foreign exchange control. He therefore concentrated on the means of financing international trade.

The main differences between the two Plans can, then, be summarised as follows:

1) While Schacht envisaged an international clearing union to finance both the balance of trade and capital movements, particularly

for third countries, with capital to be contributed by the industrial countries only, Keynes envisaged an international clearing union of all the United Nations countries, with the aim of financing international trade only.

2) While Schacht made a deposit of bonds in German Reichsmark or Gold Marks the basis for credit expansion through bank money, Keynes envisaged a new international currency unit, the *bancor*, fixed in terms of gold but only to be used as bank money for internal transfers from one clearing account to another.

3) While Schacht envisaged charges only for the debtor, Keynes envisaged charges both for creditors and debtors, holding both responsible for any imbalance created.

Nearly 25 years later, Schacht in his memoirs expressed his regret that after the war the BIS did not venture into long-term lending, leaving this to the World Bank instead. His main argument was that such a neutral bank would not have met the kind of political opposition that the World Bank did, at least initially. He further regretted that his plan had failed, in large part because of the growing French concern that the BIS deal only with the distribution of reparation payments. One can only speculate on what course events might have taken if the Schacht Plan had been realised in 1930. Perhaps the collapse of the gold exchange standard in 1931 might have been avoided.

Unfortunately, the Schacht Plan was never tested. The Keynes Plan, by contrast, was.

When the European Payments Union was created in 1950, it was based mainly on the principles of the Keynes Plan. The success of the EPU was outstanding. It freed intra-European trade and restored the European currencies to full convertibility.

The question of what Keynes knew about the Schacht Plan and what he took from it, is a matter for speculation but the similarities might not be coincidental.

*Bad Aibling*

ROLF E. LUKE