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GERMANY'S PREPARATION FOR WAR: A RE-EXAMINATION*

By BURTON KLEIN

When Germany marched against Poland in September, 1939, her military might was not questioned. The nazi government, it was commonly believed, had for six years concentrated the country's resources on preparation for war. This was a tacit assumption of the diplomacy of the period, and a point of major emphasis in the voluminous writings on Germany.

Nearly all the economic and political studies of prewar Germany agreed on three major propositions.¹ These were: (1) that in the period before 1939 Germany had succeeded in building up a military machine whose comparative strength was enormous; (2) that practically all of the increase in production from the low level of the depression was diverted into the construction of a huge war potential; (3) that all economic considerations were subordinated to the central task of preparing for war.

Even a cursory examination of the official German data recently made available shows that the validity of these propositions is questionable.² On the manpower side, for example, mobilization fell nearly a million short of the number in the armed forces at the outbreak of World War I. Nor was preparation in the industrial sphere more impressive. German aircraft production at the beginning of the war, 675 per month, was about the same as Britain's. Tanks, the main weapon of blitzkrieg warfare, were produced at the rate of 50 per month, a rate of output which was exceeded by the British. Another indication of Germany's preparedness was the state of her stockpiling program. In July, 1939, the Wehrmacht estimated that such critical items as gasoline, fuel oil, iron ore, magnesium and rubber, were in sufficient supply for only a few months' fighting.

Economic writers were, as subsequent events proved, correct in their

* The author is at Harvard University where he is engaged upon a study of Germany's wartime economy made possible by a grant from the Carnegie Corporation. This article is to be part of the study.

¹ See for example: Gustav Stolper, *German Economy 1870-1940* (New York, 1940); Henri Lichtenberger, *The Third Reich* (New York, 1947); Jurgen Kuczynski, *Germany: Economic Conditions under Fascism* (New York, 1945); Maxine Sweezy, *The Structure of the Nazi Economy* (Cambridge, 1941); "Germanicus," *Germany, the Last Four Years* (Boston and New York, 1937).

² The data presented in this paragraph were selected from *The Effects of Strategic Bombing on the German War Economy*, U. S. Bombing Survey (Washington, 1945).

belief that Germany was preparing for war. However, their interpretation of the character of the Nazi economic mobilization was wrong. In this paper it will be shown that the central proposition of these writers—that Germany was making massive war preparations—was very much exaggerated. Since a number of important economic conclusions were based on this assumption, these will have to be revised. In particular, it will be demonstrated that the proportion of output directed to war purposes was not nearly as great as has been usually supposed, and not sufficient to prevent a very substantial recovery of private consumption and investment. It also will be shown that monetary policy, far from having been made subservient to Hitler's political and economic aims, conditioned both the recovery strategy and economic mobilization for war. Inasmuch as it is impossible to disassociate rearmament from general economic strategy or general economic accomplishments, this paper will cover a number of the broad aspects of German economic history in the period 1933 to 1939. The discussion will be divided into the following parts: The Role of the Fear of Inflation in General Economic Policy; The Nature of the Economic Recovery; The Magnitude of War Preparations; and The Factors which Limited Economic Mobilization.

I. *The Fear of Inflation*

When the nazis came into power in the spring of 1933, economic activity had recovered only slightly from the lowest point of depression. The index of industrial production in the second quarter of 1933 stood at 63 (1928 = 100), only 3 per cent above the lowest point of the depression. Unemployment, which had reached 6 million in the early part of 1932, had declined by only 500,000. Other economic indices, such as gross national product, farm income, retail sales, and private capital investments, also show that in the spring of 1933 recovery had only begun.³

To solve Germany's economic problem Hitler did not introduce a "New Deal." Germany's basic economic policy for the prewar period had been initiated before the nazi accession to power.⁴ The Brüning government (1930-32) decided against devaluing the mark. Evidently, the memory of the inflation was still too fresh, and the fear that devaluation would lead to a flight from the currency was a compelling

³ See Table II p. 62 for annual data on the index of industrial production, gross national product, private investment, employment and unemployment. Data for farm income and retail sales appear in the 1938 *Statistisches Jahrbuch*.

⁴ A detailed account of German recovery policy in the years 1930-38 may be found in: C. W. Guillebeaud, *The Economic Recovery of Germany* (London, 1939), K. F. Poole, *German Financial Policies, 1932-39* (Cambridge, 1939) or in the reports of the German Institute for Business Cycle Research.

argument in this decision. This meant, of course, that Germany's power to compete in international markets would depend on the decline of her internal prices at a faster rate than those of rival countries. To this end, the Brüning government sought to accelerate the deflationary process by raising taxes and reducing those prices and wages which had not been sensitive to the general decline. The unpopularity of these measures with both the industrialists and the laborers led to the overthrow of the government.

The von Papen and von Schleicher governments which succeeded the Brüning administration (July, 1932-January, 1933) initiated a number of positive recovery measures. These included the remittance of business taxes, the reduction of interest rates, the allocation of more than a billion marks for various types of public works, and the adoption of a direct relief program.

The recovery program did not extend to the stimulus of exports by currency devaluation. This measure was not taken because these governments, like the Brüning government, feared that such a decision would lead to a currency crisis. Since it was impossible to force internal prices down further, the deterioration of Germany's competitive position—with respect to other countries which had devalued—was inevitable. As a final outcome it later became necessary to introduce exchange rationing and selective devaluation in order to obtain necessary imports. Aside from restrictions on the withdrawal of foreign currency, however, it was not at this time necessary to institute an elaborate system of exchange control because Germany still had a "favorable balance of trade."

While it was not politically possible to continue a policy of forced deflation, the von Papen and von Schleicher governments had no intention of allowing prices to rise. Two circumstances dictated the retention of price and wage controls. In the first place, these governments were concerned with the possibility that government spending would lead to an internal price rise—something which was in itself to be feared. Secondly, given the decision not to devalue, an internal price rise would have made export difficulties ever greater.

Thus, pre-Hitler German economic policy combined both inflationary and anti-inflationary tendencies. It was a program of government spending and other fiscal measures designed to increase employment and income, coupled with strict control of wages and prices to insure that the impact of public expenditures would be on employment and output rather than on wage rates or prices. The basic framework was adopted by the nazis and the difference in their program was mainly one of degree. Recovery expenditures were increased; controls over prices, wages, and foreign exchange were tightened. It is not argued,

of course, that the eventual political aims of the nazis did not differ from those of the preceding governments. But the recovery strategy initiated by the previous governments was accepted, and no fundamental change in economic policy made to accommodate the nazi rearmament program. In short, the position taken here is that the prewar nazi period was not "an economic revolution."⁵

We shall summarize the nazi additions to the recovery strategy, considering first the deflationary aspects of the program, namely, external stability of the mark and internal control of prices and wages. In reaffirming the decision not to devalue the mark, the nazis were compelled to go much further in the direction of elaborate exchange control than their predecessors. Early in 1934 the trade balance deteriorated to such an extent that Germany's gold and foreign exchange were almost depleted. In order to guarantee necessary imports, Economics Minister Schacht introduced his famous "New Plan." Under this plan exchange was rationed in order to assure its use for only those types of imports deemed essential, and the volume of these was increased by a number of ingenious devices which, in effect, reduced foreign trade to a series of barter agreements.

As the inflationary pressure of government expenditures increased, controls over prices and wages tightened. In 1936, selective price controls were superseded by a general price ceiling. All wage disputes were referred to state approved Labor Trustees who were directed to grant wage increases only in exceptional cases.

A number of writers have made the point that the price and foreign exchange policies of nazi Germany can only be explained in terms of her preparations for war, arguing that after 1934 or 1935 there was no longer any economic basis for the retention of these policies.⁶ It cannot be denied that the prevention of substantial price rises or use of import control to acquire war-important industrial raw materials are useful instruments for a war economy. And their usefulness in this respect may have provided the nazis with an additional reason for keeping them. Nevertheless, as will be seen more clearly in the latter part of this paper, the widespread fear of inflation—whether founded or unfounded—was a continuing factor which in any case provided sufficient reason for the policies actually adopted.

The second part of the nazi economic policy concerns the positive measures taken for recovery. In the "First Four-Year Plan" the nazis

⁵ Many of the economic studies of prewar Germany have taken the contrary view. See, for example, Stolper, *German Economy*, pp. 240 ff.

⁶ ". . . exchange control from the monetary and financial angles were superfluous as early as 1933 in all probability, but by 1935 for a certainty." Howard Ellis, "Exchange Control in Germany," *Quart. Jour. Econ.*, Suppl., Vol. LIV (1940), pp. 126-27.

expanded expenditures on the various public works measures initiated by the von Papen and von Schleicher governments and added a number of others to this portfolio. These measures were novel in their political implications, but in their economic content they were not much different from the attempts of the previous governments to stimulate investment and consumption. A brief account of some of these measures will indicate their twofold political and economic purpose.

Shortly after he came into power Hitler became greatly interested in equipping Germany with super-highways and in providing for the mass use of automobiles. Excise taxes on new vehicles, which as in other European countries had been extremely high, were discontinued. Expenditures on new vehicles were allowed as deductions for income tax purposes providing the purchaser scrapped his old car. The goal of self-sufficiency caused agriculture to be another favoured sector of economy. Here, in contrast to the general economy, minimum rather than maximum prices were set in order to raise agricultural incomes. The granting of marriage loans was another measure which reflected national socialist ideology. The purpose of these loans was, of course, to stimulate consumption expenditures and, even more important, to spread employment among households by taking women out of the labor market. These monetary incentives coupled with a propaganda campaign were very successful in inculcating the idea that women should remain in the home. These measures were, in fact, too successful, for their effects persisted into the period when labor became scarce.

The most widely discussed aspect of nazi recovery policy was the government-spending program and the method by which it was financed. Germany's experience provided a number of economists and publicists with an opportunity for expressing their views on the much-discussed subject of deficit finance.⁷ The main issue in this case was whether or not large-scale deficits would lead to inflation and financial ruin. One side argued that the stringent controls over prices, wages, and the capital market ruled out the possibility of an inflation. Others thought that the financial strains attendant on such a program were more than Germany could bear and predicted a collapse of her economy.⁸

The fact of the matter is that in prewar years large-scale public borrowing was not undertaken. When the recent wartime experience of the United States and Britain is considered, the German methods of finance appear extremely conservative in comparison. Table I shows,

⁷ See Otto Nathan, *Nazi War Finance and Banking* (New York, 1944); C. W. Guillebeaud, *The Recovery of Germany 1933-38* (London, 1939); Kenyon Poole, *German Financial Policies, 1932-39* (Cambridge, 1939).

⁸ See, especially, *The Banker* (London) 1937, 1938.

although total government expenditures increased from 15 billion RM in 1933 to 39 billion RM in 1938, more than four-fifths of the funds expended during this period was raised by taxation. (In contrast, from 1932-36, one-half of the United States' government expenditures were deficit financed.) The 29 billion RM increase in the deficit offered no problem since national income had increased by 75 per cent and tax receipts had doubled.

Since quick recovery was a primary aim, it well may be asked why the nazi government chose not to reduce the high tax rates instituted by the Brüning administration and to rely instead on public deficits to finance expenditures. Such a policy was, in fact, advocated by a number of German economists.⁹

TABLE I.—TOTAL REVENUES FOR FISCAL YEARS BEGINNING 1 APRIL

	National Income	Total Government Expenditures	Taxes	Non-Tax Receipts	Borrowing ^a
1933	46.5	15.3	11.4	3.5	0.4
1934	52.8	17.4	13.4	3.6	0.4
1935	59.1	23.2	13.0	3.8	6.4
1936	65.8	25.8	16.3	3.9	5.6
1937	73.8	29.1	18.8	4.8	5.5
1938	82.1	39.4	22.9	5.3	11.2
Total		150.2			29.5

^a Includes Secret Debt.

Source: see footnote 12.

Their arguments, however, had no influence on Schacht, Minister of Economics, president of the Reichsbank, and a banker by temperament. He was actually much disturbed that the propaganda machine allowed such unorthodox theories of government finance to be published "thus causing great anxiety for the economy."¹⁰ Such "anxiety" was not caused by a feeling that government deficit spending might lead to a general rise in prices. Such a possibility was precluded by the elaborate system of price and wage controls. The danger attendant on government deficits seemed to Schacht to be the destruction of confidence in the basis of the currency. And this danger could not be measured by a cost-of-living index. Just how far the government could go in increasing the debt was "something imponderable to recognize, the time of which must

⁹ See, for example, Robert Noll von der Nahmer, "Die Deckung des Oeffentlichen Bedarfs durch Nichtinflationische Papieraussgabe," *Finanzarchiv* (1934), p. 549.

¹⁰ Record of the Council of Ministers, May 12, 1936, International Military Trials, *Nazi Conspiracy and Aggression* (Washington, 1946), p. 879.

be left up to fine sensitivity."¹¹ Thus the fiscal policy pursued during the recovery is another piece of evidence regarding the nazis' fear of inflation.

As we shall later see, this fear of inflation was of considerable importance for explaining the nazi attitude toward rearmament expenditures. Before the rearmament itself can be discussed, however, it is necessary to describe generally the nature of the economic recovery. When the patterns of production, consumption, investment and employment have been summarized, it will be much easier to fit rearmament into the economic picture.

II. *The Nature of the Economic Recovery*

It would be interesting to examine the relative efficiency of the various recovery measures and to discuss the theoretical implications

TABLE II.—GERMAN ECONOMIC INDICES—1928–1938

	Gross National Product Current RM (billions)	Gross National Product 1928 RM (billions)	Index of ^a Industrial Production (1928=100)	Employment ^a of Laborers (millions)	Unemployment ^a (millions)
1928	90	90	100	18.4	1.4
1929	90	90	101	18.4	1.9
1932	58	72	59	12.9	5.6
1933	59	75	66	13.4	4.8
1934	67	84	83	15.5	2.7
1935	74	92	96	16.4	2.2
1936	83	100	107	17.6	1.6
1937	93	113	117	18.9	.9
1938	105	126	122	20.1	.4

^a *Statistisches Jahrbuch*, 1941–42, pp. 55, 410, 426.

of the high tax policy. This, however, would lead us from the main argument of this paper. For our purposes it is sufficient to say that the policies employed were quite successful in raising the national product and employment. As Table II shows, the current value of gross national product rose from 59 billion RM in 1933 to 105 billion RM in 1938.¹²

¹¹ *Ibid.*, p. 878.

¹² The limitation of space does not permit a detailed description of the method used for making the gross national product estimates. The methodology, closely following that used in this country, was based on a monograph on German National Income prepared by Paul Hermsberg at the Federal Reserve Board. The gross national product estimates were built up from the German national income data using official sources for the various adjustments. The major components, government expenditures for goods and services, gross capital formation and the foreign trade balance, were derived from official German data. Consumer expenditures were obtained as a residual.

In making gross national product estimates in constant prices, the components were deflated separately, using official price indices. It is to be noted that these indices may

A small portion of this increase was due to price rises. In 1928 prices, gross national product rose from 75 to 126 billion RM, some 70 per cent. In the same period the index of production nearly doubled, reaching a level which was 20 per cent above the 1929 peak. From 1933 to 1936 unemployment declined from 4.8 million to 1.6 million (approximately the predepression level) and by 1938 was less than .5 million.

Inspection of the main components of the national product clearly indicates that in the latter peacetime years the German economy was

TABLE III.—GERMAN GROSS NATIONAL PRODUCT—1928 PRICES
(billions RM)

	1928	1929	1932	1933	1934	1935	1936	1937	1938
Gross national product	90	90	72	75	84	92	100	113	126
Consumption	66	69	59	58	60	63	66	71	71
Private gross capital formation ^a	11	8	2	5	6	10	15	16	16
Government goods and services	13	13	11	12	18	19	19	26	39

^a Includes plant and equipment, inventory changes, residential construction, and net exports and monetary uses of gold and silver.

Source: see footnote 12.

able to provide a high level of output for both the private and public sectors of the economy.¹³ Despite the fact that government expenditures more than doubled from 1929 to 1937, the 23 billion RM increase in the real national product over this period was sufficient to permit a higher level of private consumption and investment than that which prevailed in the previous prosperity.¹⁴ Consumer expenditures, which were more stable than other segments of the national product, fell by some 15 per cent during the downswing, and by 1937 had regained the predepression level. Private investment fell more precipitously but recovered at a much faster rate than did consumer expenditures. Recovery in investment activity, which had already begun in 1933, reached the 1928 peak level during 1935 and exceeded it by 40 per cent in 1938.

understate the price rise which occurred from 1933-38, and consequently the real rise in the gross national product may be overstated. However, most of my comparisons are not between 1933 and 1938, but between the 1928, 1929 prosperity and 1938. There is no presumption that the price indices in 1938 (still nearly 20 per cent below 1928) were understated with respect to 1928 or 1929.

Anyone interested in the details of the estimates may obtain them by communicating with the author.

¹³ In the following discussion we shall use figures which have been corrected for price changes.

¹⁴ National income, the index of industrial production, and employment reached their highest levels in the years 1928 and 1929. In these two years national income (measured in 1928 prices) was about 10 per cent higher than in the previous peak year—1913.

Reducing these estimates to a *per capita* basis does not significantly alter the argument because the population increased very little over the period in which we are interested. From the 1933 depression level to 1938, total *per capita* expenditures increased 35 per cent, and in that year slightly exceeded the 1928-29 amount. *Per capita* consumption expenditures declined less than total private expenditures during the depression, and by 1938 equalled the predepression figure.

These comparisons indicate that a diversion of resources from the civilian economy occurred only to the extent that a higher government share of the national product prevented the amount of goods and services going for private purposes from increasing beyond the 1928-1929 peak level. But this is quite a different order of diversion from that which many economic writers have ascribed to the German rearmament period.¹⁵

In stating that consumer takings in 1937 were at about the same level as in the 1928-29 prosperity, it is not implied that the same can be said about the standard of living. Pronounced changes in the composition of consumption make the validity of such comparisons doubtful.¹⁶ My aim is to indicate only approximately the amount of current output which was being used for civilian consumption during the immediate prewar period as compared to 1928 and 1929. For this purpose the gross national product statistics are conceptually satisfactory.

Nor does it appear that the conclusion suggested by the consumer expenditure data is due to a statistical bias in the estimates. Comparison of the consumer expenditure figures with other indices, such as retail sales, the output of industrially produced consumer goods and food

¹⁵ "The Nazis have thus had remarkable success in achieving military goals, but the results of their policies from the point of view of civilian needs are less happy . . . per capita income, including both civilian consumption and investment, had increased only 8 per cent since the depths of the depression." Maxine Sweezy, *The Structure of Nazi Economy*, p. 204.

"We conclude that because of the philosophy of the regime, German recovery was artificial almost from the first, controlled by the government and prevented from spreading throughout all industry in the manner familiar to most upswings." Kenyon E. Poole, *German Financial Policies 1932-1939*, p. 218.

"During 1934, when it (the standard of living) was about 10 per cent below the 1928 standard, the production of consumptive goods (excluding the production of goods for their army force and navy) had about reached its peak: 1935, 1936, 1937, 1938 and the first nine months of 1939 brought no increase in Germany proper." Jurgen Kuczynski, *Germany: Economic and Labor Conditions under Fascism*, p. 60.

¹⁶ In the field of food consumption the social investigator may be on a little more solid ground. Here, there is no evidence that the German diet deteriorated in the period between 1928 and 1938. Total per capita calory consumption declined about 6 per cent from 1929 to 1933, and by 1937 was again at the prosperity standard. A more detailed comparison of 1938 and 1928 shows that consumption of beer, eggs, cheese, wheat, flour and margarine had decreased somewhat during this period. On the other hand, consumption of meat, lard, butter, fish, potatoes, rice and coffee increased. Source: *Wirtschaft und Statistik*, 1939, p. 463; *Statistisches Jahrbuch*, 1937, pp. 362-63, and 1941-42, p. 437.

consumption, or with German estimates of aggregate consumption does not indicate that they overstate consumption in 1938 compared to that in 1928 or 1929.¹⁷

That the level of civilian production in the late peacetime years was high can also be inferred from the level of output of civilian items which competed directly with war production for raw material use and which, therefore, should have been the first to show the impact of a large war program. Private residential construction and consumer durables are examples of such marginal items. Actually, we find that 336,000 dwelling units were erected in 1937, only one per cent below the high construction year, 1929.¹⁸ The decline in residential construction in 1938 was less than 10 per cent. The 1938 production of automobiles for the civilian economy was at a record level and double the 1929 output.¹⁹ The 1937 and 1938 production of such other consumer durables as furniture and radios was also appreciably above the 1928-29 level.

Since capital formation is such an important aspect of rearmament we shall examine the investment picture in some detail. The object of this investigation is to determine the extent to which investment was channelled into those sectors of the economy which would increase Germany's war production potential. In this discussion we shall deal with gross investment in construction and producer durables, and include public as well as private capital formation.

For the purpose of this investigation, investments have been classified under three group headings:²⁰ Armament Factories and Military Facilities; The Basic Industries; Civilian and Government Non-War. The first and second categories may be viewed as the war potential, the third as types of investment which had little or no direct relevance for war preparations. The investment figures falling under these three main categories are given in Table IV. Some of the classifications may be questioned. For example, investments in super-highways (Reichsautobahnen) appear in Group III when they were allegedly for military purposes. It appears, however, that gasoline was so short even in pre-

¹⁷ German estimates of consumer expenditures only cover the years 1928-31 and 1938. In the former years these estimates were within a few per cent of those presented in this paper and, in the last year, about 10 per cent above. Consumer expenditure estimates for the years 1925-31 appear in *Archiv für Sozialwissenschaft und Sozialpolitik*, Bd. 67, Heft 2, April, 1932. The estimate for 1938 appears in a monograph prepared by Paul Grunig, a statistician for the Central Statistical Office.

¹⁸ *The Effects of Strategic Bombing on the German War Economy*, p. 231.

¹⁹ *Ibid.*, p. 281.

²⁰ Unfortunately there is no unequivocal method of classifying investments into war and non-war categories. Almost every investment in plant, equipment, roads, etc., has some relevance for military output. In the case of Germany the difficulty is further enhanced by the fact that the statistics do not permit as fine a breakdown of capital formation as is necessary to make the desired classification. In spite of these difficulties, however, much can be learned by classifying and studying those sub-groups of data as are available.

war years that motor transportation was quite unimportant for either industrial or military purposes. Group I, on the other hand, includes too much for all vehicle and other metalworking, electrical, and chemical plants have been classified as armament-producing plants, whether or not they were so engaged. Recognizing, however, that such a procedure

TABLE IV.—TOTAL INVESTMENT CLASSIFIED BY PURPOSE
(billions RM)

	1928	1933	1934	1935	1936	1937	1938
Group I	.8	.2	.4	1.9	3.3	4.3	5.3
Armament plants ^a	.8	.2	.4	.6	.9	1.2	1.6
Military facilities ^b				1.3	2.4	3.1	3.7
Group II	4.2	1.5	2.1	2.6	3.0	3.7	4.5
Heavy industry ^c	.9	.1	.3	.6	.8	1.0	1.3
Railroads and other transportation equipment	1.3	.6	.8	.8	.9	1.1	1.5
Agriculture	.9	.6	.7	.8	.9	1.0	1.1
Public utilities	1.0	.2	.3	.4	.5	.6	.7
Group III	8.6	3.3	5.4	6.6	7.9	7.9	8.6
Other industry ^d	.9	.3	.3	.4	.5	.6	.8
Residential construction	2.8	.9	1.4	1.6	2.2	2.1	2.2
Commercial, handicraft, miscellaneous	1.7	.7	.7	.8	.9	1.0	1.0
Roads	.5	.3	.6	.9	1.2	1.2	1.8
Other government ^e	2.7	1.1	2.4	2.4	3.2	2.9	2.9
Total	13.7	5.1	8.3	11.1	14.2	15.9	18.5

^a Electrical machinery, vehicle, locomotive, naval, metal-working, optical and chemical industries.

^b Barracks, airfields, fortifications, etc. (more than 2 billion RM were spent on fortifications in 1938 and 1939).

^c Steel, coal, construction materials, and rubber industries.

^d Clothing, food, printing and publishing, linoleum, paper and musical instrument industries.

^e Postal system, trams and subways, waterways, government and partly buildings, municipal improvements, etc.

Source: see footnote 12.

is necessarily arbitrary and that it must be accommodated to the form in which the data are published, it nevertheless provides a reasonable basis for analyzing the nature of German investments.

It will be observed that in the years 1933-38 more than 50 per cent of total public and private investment fell into Group III. Even 1938, the last peacetime year, the current value of these non-war types of investment was as large as in 1928. Measured in constant prices, their real volume was 20 per cent higher in 1938 than it had been in 1928. Public expenditures on roads and buildings formed the largest component of Group III. In the years 1936-38 such undertakings averaged

about 4.5 billion marks annually—nearly 5 per cent of Germany's gross national product.

Those types of investment classified under Group I and Group II make up Germany's total war potential. The industrial war potential, usually referred to as *the* war potential, is a narrower concept, excluding military construction. Inspection of the figures in the above table shows investment in armament plants and Germany's basic industries to be a surprisingly small part of total investment. Investment in Group II industries, which included the iron and steel plants, the coal mines, the transportation system and public utilities, was exceeded every year by expenditures on road construction and government buildings. Comparing the Group II totals for the years 1933-38 with the 1928 figure, we find that it was not until 1938 that the 1928 level was surpassed. Investment expenditures on that part of Group I which we have called armament plants were, relatively speaking, exceedingly small. Annual expenditures on these facilities for the years 1933 through 1938 averaged only half as much as those on residential construction. Thus, inspection of Germany's prewar pattern of investment shows that there was no pronounced concentration of investment in those activities associated with economic preparations for war.

The fact that private capital formation was generally high in the latter part of the 1930's only indicates that Germany was experiencing a substantial economic recovery. That investment expenditures are the most dynamic component of the national product, falling furthest during the downswing and increasing fastest during the upswing, is a well-established proposition in business cycle theory. Calculations of the German Business Cycle Research Institute show that from 1931 through 1936 private gross investment in plant and equipment was not sufficient to maintain industrial capacity. Net industrial disinvestment during this period was put at nearly 3 billion marks.²¹ A large volume of plant expenditures was required in the years after 1936, therefore, merely to offset previous capital consumption and to provide for current maintenance. Thus, gross industrial investment in 1938 of 3.7 billion marks, although 50 per cent greater than in 1928, can hardly be viewed as abnormal.²² This year was preceded by only one year of positive net investment whereas in the previous decade net investment had increased steadily since 1923.²³

Summing up our observations on the composition of Germany's prewar gross national product: It is apparent that an enormous diversion of resources from the civilian to the war sector of the economy did not occur, for both consumption and non-war types of investment reached

²¹ *Statistisches Jahrbuch*, 1939-40, pp. 583, 584.

²² *Loc. cit.*

²³ *Loc. cit.*

the prosperity levels of 1928 and 1929. This is also true in regard to government non-war expenditures.²⁴ Thus, it is only possible to speak of a diversion of resources in the sense that private expenditures did not rise above the 1928-29 peak amount to the full extent of the increase in the gross national product. This does not mean that the economic achievements of the recovery period were unimportant for

TABLE V.—GOVERNMENT EXPENDITURES FOR GOODS AND SERVICES
(billions RM)

Fiscal Year Beginning April	Total Government Expenditures for Goods and Services	Armament Expenditures
1933 and 34	21	5
1935	14	6
1936	17	10
1937	21	14
1938	30	16
Total	103	51

Source: These figures have been obtained by consulting the war finance discussions of the Council of Ministers contained in *Nazi Conspiracy and Aggression* (Washington, 1946). In answer to an American interrogation, Schacht stated that he and von Krosigk (Minister of Finance) placed total armament expenditures at 45 billion RM. Defining armament expenditures to include total net private investment will add less than 2 billion RM to this figure.

Germany's war preparations. Full employment, a high level of total output, and a large production of capital goods, are in themselves important contributions to a nation's war-making ability.

III. *The Magnitude of War Preparations*

At the outset it is necessary to define what we shall mean by armament expenditures. There is no unequivocal definition. We shall use the term to include military pay and rations, and public expenditures on military establishments, fortifications, war material, and armament plants. This roughly corresponds to the definition used by the War Production Board in this country.

Most discussions of Germany's war preparations begin with Hitler's boast that the nazis had spent 90 billion RM on rearmament. It is paradoxical that this statistic was accepted quite uncritically at a time when nearly all other German data was suspect.²⁵ The reason, of course, is simply that it was commonly believed that preparation for war

²⁴ See Table V, above.

²⁵ In calculating a residual of private investment and consumption, Mrs. Sweezy uses a figure of 90 billion (*op. cit.*, p. 205). Nathan uses his own figure of 75 billion RM, but thinks that it is understated (*op. cit.*, p. 88). Neither of these authors defines armament expenditures.

claimed the highest priority on the economy. Actually, according to our definition, 51 billions were spent on rearmament in the six fiscal years ending March 31, 1939, and about 55 billions up to the outbreak of war.

This corresponds to a little less than 50 per cent of total public expenditures for goods and services, and about 10 per cent of the gross national product produced during this six-year period. A German economist has pointed out that Hitler's 90 billion figure would imply a higher ratio of total output going for war purposes than was reached until the latter part of the war. On the deception of foreigners he remarks "Public views of the scale of armament were very much exaggerated. The German government of the time did nothing to contradict the exaggerated ideas; on the contrary they probably seemed to be desirable as propaganda, producing the illusion of a warlike strength which in reality was not available on that scale."²⁶

It is convenient to divide the discussion of rearmament into two periods: that which occurred before 1936 and that which occurred from 1936 to the beginning of the war. Up to the time of the German reoccupation of the Rhineland in the spring of 1936, rearmament was largely a myth. In the three years ending March 31, 1936, some 11 billion RM were spent; more than one-half of this in the fiscal year 1935-36. In other words, about 3 per cent of the total national output went for war purposes. It is perhaps easier to assess the state of preparedness by looking at the size of the army. At this time the German army was no larger than the French; it numbered less than 500,000 men and was composed of the equivalent of some 25 full strength divisions.²⁷ Before 1936, plans for the speedy creation of a large offensive army did not exist. At the time of conscription legislation was passed in March, 1935, it was planned to bring the army up to a strength of 700,000, and that only by 1939.²⁸

The second phase of German rearmament began in the summer of 1936 when Hitler decided to start rearming on an intensive scale. Undoubtedly this decision was influenced by German intelligence reports which placed the strength of the Russian army at nearly one million. Such "Bolshevist" superiority was greatly feared, and preparations were begun under the Second Four-Year Plan to assure German dominance of Europe.

The language of the memorandum delivered to Goering on his appointment as Plenipotentiary of the Second Four-Year Plan in October,

²⁶ Rolf Wagenfuehr, *Aufstieg und Niedergang der Deutschen Rüstung* (Berlin, March, 1945), p. 8.

²⁷ *German Army Mobilization*, Intelligence Division, War Dept. (1946). This study is based on captured German documents. The estimate of French military strength comes from Reynaud, *Le Problème Militaire Française*, 1937, p. 27. Reynaud's estimate of German strength at this time was 800,000; nearly twice the actual size.

²⁸ *Ibid.*, p. 9.

1936, leaves no doubt as to Hitler's desire to begin full-scale preparation for war.²⁹ This document begins with Hitler's declaration that war is inevitable. In the first place, Hitler asserts "it will be Germany's task to defend Europe against Bolshevism"³⁰ and secondly, "a final solution of the food problem only can come through an expansion of living space" (Lebensraum). Following these pronouncements Hitler denounced Schacht's Economics Ministry for sabotaging rearmament, accusing Schacht of having no comprehension of economic mobilization. Finally Goering was given two commands: (1) "The German army must be ready for commitment in four years"; (2) "The German economy must be ready for war in four years."

Hitler did not indicate the strength of military forces, or the size of the economic effort which would be required to prepare Germany for its "historic task." Nor, to my knowledge, has such a plan been found in the German archives. It is difficult, therefore, to gauge just how high the nazis had set their sights. (We shall return to this subject later.) But, at any rate, it does not appear that the extent of mobilization before the actual outbreak of war measured up to the Fuehrer's edict of "unconditional subordination of all other desires to preserve Germany's national existence."

In the three fiscal years ending March 31, 1939, Germany spent 40 billion RM for rearmament. In 1938-39, the last peacetime year, military expenditure amounted to 16 billion marks, a sum equivalent to 15 per cent of Germany's gross national product. Actually, the share of the German national output going for armaments was not much higher than that of the Allies prior to their entry into the war. Total British war expenditures in 1939 constituted nearly 15 per cent of her gross national product, and were only slightly less than Germany's.³¹ In 1941, the year before the United States went to war, the war expenditure ratio was about 10 per cent—and would imply a higher absolute volume of armament expenditures than Germany's.

Comprehensive statistics on munitions production in the immediate prewar years are lacking. Such data on output or stocks as are available indicate that the production of war goods, like total military strength, has been considerably exaggerated.

²⁹ A photostat of this document is in the files of the United States Strategic Bombing Survey.

³⁰ ". . . the world is drifting with ever increasing speed into a new conflict, whose most extreme solution is called Bolshevism. One has to compare the Red Army as it really is today with the assumptions of the military ten or fifteen years ago to gauge the dangerous extent of this development. Germany will have to be considered as the focal point of the Occidental world against Bolshevist attack."

³¹ *World Munitions Production 1938-1944*. War Production Board. The definitions of war production and gross national product are roughly comparable to those which have been used for Germany.

The nazis placed heavy emphasis on the importance of air power, allocating nearly one-half of prewar military expenditures to the Luftwaffe. A large aircraft output was therefore to be expected. Total monthly aircraft production³² rose from 30 in 1933 to 425 in 1936 and remained at this level through 1938. In 1939, total output rose by 60 per cent. At the outbreak of war, output of combat types was 500 a month, 60 per cent of the production rate credited to Germany by British Intelligence.³³ Germany entered the war with an air force of 1,000 bombers, and 1,050 fighters, which was still not an inconsiderable number compared to the air strength of her enemies.³²

Before 1938 Germany produced only the very light Mark I and Mark II tanks—types which were outmoded soon after the beginning of the war. Production of the Mark III began in 1938, and the Mark IV, in 1939. In the last three months of 1939 Germany produced 247 tanks,³⁴ and 45 per cent of the Intelligence estimate of German production.³⁴

A more dramatic indication of Germany's state of preparedness is to be found in the 1939 plot against Hitler. In the summer of 1938 Hitler informed his confidants of his plans to invade Czechoslovakia if it became impossible to strike a bargain with England. This plan was opposed by a group of high army and civilian officials. Included in the group were General Beck, Chief of Staff, General von Witzleben, Commander of the Third Army, General Thomas, Production Chief of the High Command, former Economics Minister Schacht, and Goerdeler, former Lord Mayor of Leipzig. Some of these names will be recognized as principals in the 1944 Plot. The opposition of this clique was based on the assumption that the English would not back down, and that the Wehrmacht was totally unprepared to withstand a coalition of European powers. (In the fall of 1938 Germany had 35 infantry and 4 motorized divisions and according to testimony of German generals, these were neither fully equipped nor fully manned.) Foreseeing another Versailles, these generals formed a conspiracy to seize Hitler and remove the nazis from power by a military *coup d'état*. According to the documentary evidence Theodore Kordt, the German chargé in London, informed Halifax of the plot, urging Britain to stand firm. As it was planned, Beck resigned early in September when he was informed of Hitler's certain decision to take action. Before the date planned for the conspiracy, however, it was learned that Chamberlain would go to Godesberg on September 13. This knowledge seemed to indicate that their original premise was wrong; that Hitler's bluff would be success-

³² *The Effects of Strategic Bombing*, p. 149.

³³ *An Appraisal of Pre and Post Raid Intelligence*, U. S. Strategic Bombing Survey (Washington, 1945).

³⁴ *Loc. cit.*

ful. The plot was called off and von Halder, one of the conspirators, accepted Beck's vacated post.³⁵

IV. *The Factors which Limited Economic Mobilization*

In discussing the reasons why Germany's preparations were not greater, it is necessary to separate political and military from economic factors. The latter supply us with the immediate reasons for Germany's unpreparedness; the former, with the more ultimate causes. We can, perhaps, make this distinction more clear by attempting to answer two different sorts of questions: (1) Why did the Germans not prepare for a major war—on the enormous scale which popular opinion assumed them to be preparing? (2) Why were their preparations not tolerably larger—say, 25 per cent? We shall begin with the second question.

A nation's real war potential is limited by two factors; the total amount of production which can be obtained from its resources, and the share of this output which can be converted to war purposes. In the prewar years, at least, there is no evidence that armaments output was circumscribed by either of these factors.

In the first place, it is clear that a much larger share of the 1938 national product could have been used for war purposes. Civilian consumption and investment were, as we have seen, at the 1928-29 levels; while, at the same time, the government was undertaking a huge non-war program. Thus it would appear that it might have been possible for the Germans to have doubled war output by cutting the overall level of civilian production by 10 or 15 per cent.

Nor does it appear that it was at this time impossible for the Germans to have secured a larger war output through an expansion of their national product. Although full employment had been reached before 1938, and the 1929 level of production was exceeded by 25 per cent in this year, Germany still had not exhausted her expansionary possibilities. Formal proof of this proposition depends on an examination of the manpower and raw material situation, but its plausibility can be gauged by reference to the wartime performances of Britain and the United States. In these countries it has been quite clearly demonstrated that full employment did not signify a capacity level of production. Subject to outside pressure, production showed an elasticity which was astonishing. This also was shown at a later date in Germany.

We may sum up this argument by saying that although it may not have been possible to increase war output while maintaining all types of civilian output (automobiles and refrigerators, for example), op-

³⁵ An account of this plot is to be found in the "Twentieth of July," Franklin Ford, *Am. Hist. Rev.* (July, 1946). Also consulted were interrogations of Thomas, Schacht, von Halder and documentary evidence presented at the War Crimes Trials.

portunity still existed as late as 1938 for increasing military preparations without causing an appreciable decline in the general level of civilian output. It is seen, therefore, that "real" factors cannot explain why Germany did not produce more war material.

The explanation of Germany's failure to prepare on a much larger scale is essentially a financial one. The German leaders simply did not at this time, understand the elementary economic lesson that "a nation can finance everything which can be produced."³⁶ As will be shown, financing a higher level of war expenditures by raising already high tax rates was not regarded as expedient. And procuring additional funds by borrowing, would, it was thought, destroy confidence in the currency and lead to an inflation. This fear of inflation, as we have seen, weighed heavily in the policy decisions of the whole decade: it was an important consideration in the decision of the Brüning government against devaluation and coincidentally in the adoption of the policy of forced deflation; it led to the retention of this policy after the inflationary argument was, from an economic standpoint, no longer valid; it prevented the nazis from reducing taxes when their primary aim was a speedy recovery. It is not surprising, therefore, that financial considerations impeded rearmament.

One of the strongest exponents of this school of financial conservatism was Schacht. Although he was already in disfavour with Hitler by 1936, Schacht remained Minister of Economics until August, 1937, and president of the Reichsbank until January, 1939. And until his dismissal from the Reichsbank, his financial views pretty well dominated nazi economic policy. Schacht's testimony indicates that he was dismissed, not because he opposed rearmament on social or political grounds, but because large rearmament expenditures were inconsistent with his views on sound finance.³⁷

By 1937, he stated, the financial position of the Reichsbank had become so precarious that he advised Hitler that additional credits for rearmament could not be raised. Hitler finally persuaded him to provide the government with another three billions, but only on the condition that this was to be the last. After March, 1938, Schacht stated that he refused to give another penny for rearmament, and in January, 1939 his one-year appointment was not renewed. There is nothing in the documentary evidence which would deny the veracity of Schacht's story.

³⁶ Mr. Nathan's conclusion that Germany had learned this before the democracies is hardly valid. *Op. cit.*, p. 90.

³⁷ This account of Schacht's dismissal is taken from his testimony to Clifford Hynning of the United States Group Control Council; from interrogation reports of the United States Strategic Bombing Survey made by Paul Baran and the author and from the record of his testimony at the International Military Trial.

At the meeting of the Council of Ministers on May 12, 1936, the possibility of increasing armament expenditures was discussed.³⁸ The Minister of Finance, von Krosigk, did not think that an additional 6 or 7 billions could be raised by taxes. In conformity with universal standards of political behaviour this was denied by none of the ministers. This passed the responsibility for obtaining more funds to the Reichsbank; Schacht summed up the past accomplishments of the Reichsbank, declaring that with unswerving loyalty to the Fuehrer he had raised 11 billions for rearmament and re-employment. The Reichsbank could go on, he said, and raise some 2 billions annually, but, he asserted, the money market would not support the 8 or 9 billion requested. If the Reichsbank were to be pushed further, Schacht left no doubts as to his own position: "Dr. Schacht will never be a party to an inflation; the Fuehrer also had decided in this sense. The danger of such a development is imminent. If a road is to be taken, which contains this danger, Dr. Schacht would like to drop out in time, so that he does not disturb the new course."³⁹

Goering voiced his skepticism by commenting that "measures which in a state with a parliamentary government would probably bring about inflation do not have the same results in a totalitarian state." But he did not press his argument further.

It might be pointed out that Schacht quite successfully withstood the pressure for higher armament expenditures. In the fiscal year 1936-37, they were only 4 billions more than in the previous year.

Whenever the question came up, Schacht took the same firm position of the danger of public deficits. At a meeting of the Council of Ministers in May, 1937,⁴⁰ Goering began by asking what objections there might be to producing substitute materials in the Reich. Schacht replied that there were no theoretical objections, that self-sufficiency was absolutely necessary, but that on the practical side there would be serious difficulties—the question of finance. "Providing money by taxing capital is impossible. The circulation of money cannot be increased beyond a certain amount. Previous measures have been executed correctly and without danger to the monetary value. A further increase seems precarious, a matter of confidence."⁴¹

By 1938, when Hitler was completely out of patience with Schacht's economic ideas, it might have been expected that the nazis would have at last freed themselves from their financial yoke. But the evidence does not confirm this suspicion.

³⁸ *Nazi Conspiracy and Aggression*, pp. 868-72.

³⁹ *Ibid.*, p. 869.

⁴⁰ *Ibid.*, pp. 878-84.

⁴¹ *Ibid.*, p. 879. It may be noted that the debt increased by more than 250 billion RM during the war, with neither a substantial rise in prices, nor a financial collapse.

During the fall of 1938, when the Sudetenland issue was pending, military expenditures were increased sharply. Although expenditure data for these months are not available, they could not have been very large, which is shown by the fact that from April through October military expenditures totalled only some 9 billions. On the 7th of December an order signed by Keitel went to the commanders of the three services stating that: "The strained financial situation of the Reich makes it necessary that for the rest of the current fiscal year 1938-39 the expenses of the Armed Forces, which in the last months under the strain of extraordinary circumstances have undergone a considerable increase, should be lowered again to a level, which would be tolerable for some time."⁴² It was ordered that total military expenditures for the last five months of the fiscal year were not to exceed 6.9 billion. The provisional budget for 1938-39 was set at 11.5 billion RM, 30 per cent below expenditures of the previous fiscal year.⁴³

For the purpose of explaining why Germany's war preparations were not larger, the financial bottleneck provides us with the necessary, but not the sufficient conditions. For, if additional funds could not be obtained through borrowing or taxation, it still would have been possible to obtain these by cutting non-war expenditures. There were some 15 billion RM, in the fiscal year 1938-39, nearly 75 per cent greater than when the nazis came into power. Especially prominent in the civil budget were public investments in highways, party buildings, municipal improvements and the like.⁴⁴

If non-war expenditures were not reduced, it was not the fault of Schacht; in every discussion of public finance he preached economy in government expenditures. In proposing specific cuts, however, he was invariably opposed by some faction of the party, and succeeded only in getting himself thoroughly in disfavour with the nazi politicians. It was, in fact, even difficult for Schacht to compel the semi-autonomous political organizations to submit their budgets to the Ministry of Finance.⁴⁵

When rearmament was speeded up during the time of the Czech crisis, Goering began to take a firmer stand on the reduction of non-war expenditures. But not much was done in this respect before the beginning of the war. Goering's speech before the Air Ministry in October, 1938, was a forecast of action which was to come only at a later date.

He (Goering) is going to make barbaric use of his plenipotentiary power

⁴² *Ibid.*, p. 907.

⁴³ *Ibid.*, p. 908.

⁴⁴ See Table IV, p. 66.

⁴⁵ *Nazi Conspiracy and Aggression*, pp. 845-46 and 878.

which was given to him by the Fuehrer. All the wishes and plans of the state, party and other agencies which are not entirely in this line have to be rejected without pity. . . . He warns all agencies, particularly the Labor Front, from interfering with these proposals in any way. He is going to proceed ruthlessly against every interference on the part of the Labor Front. The Labor Front would not receive raw materials and workers for its tasks any more. Similarly all other party requirements have to be set aside without consideration. At the present time the plants should not be burdened with unnecessary demands, such as athletic fields, casinos or similar desires of the Labor Front.⁴⁶

This discussion of financial impediments to rearmament provides some insight into nazi politics. The fear of increasing the debt because it would destroy confidence, the unwillingness to raise taxes, the difficulties of reducing particular types of government expenditures—all indicate that Hitler was less able to subordinate the various private interests to his central task of preparing for war than has been commonly assumed. It will be the task of the political experts to reassess the nazi political system, to find out the extent to which Hitler had to compromise with various interests, and to identify these interests. When this has been done, the nazi economic picture will be clearer.

These fiscal considerations do not explain, however, why Germany did not undertake really large-scale preparations for war. The various minutes of meetings pertaining to the discussion of the rearmament question indicate that the nazi leaders were thinking only in terms of increasing military expenditures by a few billion reichsmarks, or of adding several divisions to the army. It is unlikely, therefore, even if finances had not stood in the way, that the rearmament program would have been more than some 20 or 30 per cent larger.

The fundamental reason why large war preparations were not undertaken is simply that Hitler's concept of warfare did not require them. Documentary evidence and interrogation of his confidants indicate that for the fulfillment of his territorial desires, Hitler did not expect to fight a protracted war against a coalition of major powers. Rather, he planned to solve Germany's living space problem in piecemeal fashion—by a series of small wars. His strategy, as it developed, was to undermine an enemy's internal and external political unity, to intimidate him with threats of military destruction, and if this were not successful, to force a speedy capitulation by Blitz warfare. All this was to occur in so short a time that the democracies could be presented with a *fait accompli* while they were still debating whether or not to intervene.⁴⁷ Italy's experience against Abyssinia, the occupation of the

⁴⁶ Notes of speech by Goering at Reich Air Ministry, *ibid.*, p. 901.

⁴⁷ The directive for the operation "Green" (conquest of Czechoslovakia) stated: ". . . it is essential to create a situation within the first four days which plainly demonstrates, to hostile nations eager to intervene, the hopelessness of the Czechoslovakian military situation." *Ibid.*, p. 311.

Rhineland, the conquest of Czechoslovakia, all indicated that the process could be repeated against Poland, the Balkans, and after a period of consolidation, against the coveted Ukraine.

The only nations which could be considered as threats to German expansion were the United States, Russia, France and England. Before the outbreak of war, the possibility of American intervention was considered remote. Although Hitler frequently spoke of Germany's future task of defending Europe against Bolshevism, Russia was not considered an immediate threat. Russia could be dealt with in the future, after Germany was able to draw on the war potential of Western Europe. For this conflict Hitler counted on the neutrality, if not the active participation, of the democracies. Hitler always took England and France into account in his war plans, but he did not think that they would intervene.⁴⁸ England, he thought, would not be able to fight without the support of the colonies. And he doubted if they would support the Mother Country in a European conflict.⁴⁹ Besides, he thought it unlikely that England would wish to destroy Europe's "bulwark against Communism." As early as 1937 Hitler saw the possibility of a social and political decay in France which would leave her incapable of offering active resistance.⁵⁰

Hitler's strategy, then, did not involve large war preparations, but only immediate military superiority over France and England. For this, 50 or 60 well-trained divisions and an air force of 2,000 planes were regarded as adequate. This hypothesis was confirmed by the first two years of fighting.

The faulty appraisal of the prewar nazi economy was primarily due to the inability of political and economic writers to appreciate the economic significance of this Blitzkrieg strategy. They failed to see that such a strategy did not involve a large use of resources and that it permitted, together with minimal war preparations, a prosperous civilian economy. Another reason why their economic picture was distorted was the implicit belief that nazis would make their financial policy subservient to the economic rearmament program rather than having to adapt the scale of war preparations to the principles of financial conservatism.

⁴⁸ Hitler was confident that the invasion of Poland would not bring England and France into the war, and later, after Poland was conquered, he expected that they would agree to his peace terms.

⁴⁹ *Ibid.*, pp. 297-304.

⁵⁰ Conference of the Reichskanzlei, November, 1937. "Should the social tensions in France lead to an internal political crisis of such dimensions that it absorbs the French army and thus renders it incapable for employment in war against Germany, then the time for action against Czechoslovakia has come." *Ibid.*, p. 301.