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Abstract

The Nazis inherited a weak economy, withered by the Great Depression and periods of hyperinflation, when they took power in 1933. Over the next six years, primarily through a military buildup, the Nazi economy grew like none other in the world. This paper traces the methods the Nazis used to finance this economic rebound. Through an analysis of secret government documents, Nuremberg witness statements, and the latest scholarly research, this paper posits that the methods used to finance the economy were unsustainable. Further, it finds that by September 1939, the economy was in a state of dangerous disarray.

Keywords

Nazis, Great Depression, Hyperinflation, Economic Development, Military Buildup, Nazi Germany

The Nazi Fiscal Cliff: Unsustainable Financial Practices before World War II

By
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The Great Depression hit Germany harder than it did any other European country.¹ With a fragile economy that was financed primarily by foreign short term loans, the country endured a banking crisis when the 1929 stock market crash caused these loans to be called back. The crisis reached its trough at the close of 1931 when Herbert Hoover had to allow Germany a one year reparations holiday to avoid a total economic collapse. Three successive governments failed to stimulate employment before the Nazis came to power in January 1933.² The ensuing miraculous growth of the German economy, the quickest in history, causes one to ask how the government financed the recovery.³ This paper attempts to document the Nazis' financing methods, both on a domestic and global scale. It argues that these methods were unsustainable, leading to economic uncertainty by the time war broke out in 1939.

Upon taking power, the Nazis immediately implemented an expansionary fiscal policy that encouraged job growth through

¹ Albrecht Ritschl, "Deficit Spending in the Nazi Recovery, 1933–1938: A Critical Reassessment," *Journal of the Japanese and International Economies* 16, no. 4 (December 2002): 561.

² Hans-Erich Volkmann, "The National Socialist Economy in Preparation for War," in *Germany and the Second World War*, vol. 1 (Oxford: Clarendon Press, 1990), 161–63.

³ Adam Tooze, *The Wages of Destruction: The Making and Breaking of the Nazi Economy* (New York: Penguin, 2006), xxv.

civil building projects and the rearmament of the German military.⁴ Over 140,126 jobs were created in July 1933 as opposed to 23,665 in January 1933. By November the average monthly growth in jobs had reached 400,000.⁵ This extremely positive growth trend continued to 1936, at which time the economy reached full employment.⁶ The Gross National Product (GNP) increased 9% annually while state demand as a share of GNP increased from 14% to 31% between 1933 and 1938.⁷ The Nazis paradoxically managed to keep inflation and deficit spending low during this remarkable feat of government sponsored recovery.⁸ Though these statistics suggest a command economy had taken hold, the Nazis actually undertook a campaign of privatizing businesses.⁹ The resulting set of circumstances led one 21st century economist to remark

⁴ Raymond L Cohn, "Fiscal Policy in Germany During the Great Depression," *Explorations in Economic History* 29, no. 3 (July 1, 1992): 338; Rainer Fremdling and Reiner Stäglin, "Work Creation and Rearmament in Germany 1933-1938: A Revisionist Assessment of NS-Economic Policy Based on Input-Output Analysis" (Discussion Papers, Deutsches Institut für Wirtschaftsforschung, 2015), 1.

⁵ R. J. Overy, *The Nazi Economic Recovery, 1932-1938* (London: Macmillan Press, 1982), 53.

⁶ Cohn, "Fiscal Policy in Germany During the Great Depression," 319.

⁷ Guido Giacomo Preparata, "Money for the Third Reich: The Nazis' Financial Legerdemain, 1933-1938" (Ph.D., University of Southern California, 1998), 7; Christoph Buchheim and Jonas Scherner, "The Role of Private Property in the Nazi Economy: The Case of Industry," *The Journal of Economic History* 66, no. 2 (June 2006): 390.

⁸ Burton H. Klein, *Germany's Economic Preparations for War* (Cambridge: Harvard University Press, 1959), 32.

⁹ Germà Bel, "Against the Mainstream: Nazi Privatization in 1930s Germany," *The Economic History Review* 63, no. 1 (February 1, 2010): 35-37. Command economies exist when the central government plans the nation's major economic ventures. A key characteristic of command economies is government ownership of the state's largest companies.

We conclude that the Nazi recovery was not a textbook exercise in Keynesian demand stimulation... Economic recovery in Germany in the 1930s remains the paradox case of public demand expansion without Keynesian demand creation.¹⁰

The catalyst for such an atypical recovery was a sustained government campaign to grow the military. Full scale rearmament had begun by 1934, and 70% of government expenditures had gone toward it by 1939.¹¹ However, the Nazis felt it necessary to completely hide such spending from official figures until March 1935 since rearmament was illegal per the Treaty of Versailles.¹² There was the added concern of causing inflation. It was clear that early in the Nazis' reign Hitler did not want to induce inflation, which would scare Germans, who had vivid memories of the 1923 hyperinflation.¹³ He was even willing to harm Germany's fragile foreign trade position to inhibit inflation.¹⁴

¹⁰ Ritschl, "Deficit Spending in the Nazi Recovery, 1933–1938," 577.

¹¹ Ibid.; Fremdlin and Stäglin, "Work Creation and Rearmament in Germany 1933-1938," 23; David Sanz Bas, "An Austrian Analysis of the Nazi Economic Recovery (1933-1939)," *Procesos de Mercado* 8, no. 1 (Spring 2011): 294.

¹² Hjalmar Schacht, "Unsigned Schacht Memorandum to Hitler Concerning the Financing of the Armament Program," May 3, 1935, 2, 1168-PS, In *Nazi Conspiracy and Aggression*. United States Government Printing Office, 1946. The Nazis no longer needed to hide military spending figures because, in March of 1935, Hitler announced Germany's rearmament plans to the world, officially breaking one of the world's worst kept secrets.

¹³ Harold James, "Schacht's Attempted Defection from Hitler's Germany," *The Historical Journal* 30, no. 3 (1987): 729; Tooze, *The Wages of Destruction*, 76; Martin Wolfe, "The Development of Nazi Monetary Policy," *The Journal of Economic History* 15, no. 4 (December 1, 1955): 392.

¹⁴ "Affidavit I of Emil Puhl," November 7, 1945, 3, EC-437, In *Nazi Conspiracy and Aggression*. United States Government Printing Office, 1946.; Klein, *Germany's Economic Preparations for War*, 5.

Hitler essentially wanted all the positives of heavy government spending without the negatives. In response, the architect of the recovery, Reichsbank President Hjalmar Schacht, created MeFo bills. At their simplest, MeFo bills were bills of exchange.¹⁵ They were issued by the industrial company Metallurgische ForschungsAnstalt (Metallurgical Research Institution). But this company was a dummy corporation, cobbled together by Schacht and German heads of industry with a capitalization of only 250,000 Reichsmarks (RM).¹⁶ The MeFo corporation would fund rearmament projects by issuing these bills of exchange, which contractors could discount for RMs at private banks. These banks were willing to hold MeFo bills because the Reichsbank, Germany's central bank, guaranteed to re-discount them. To further entice investors, MeFo bills carried an interest rate of 4%, which was higher than that of other trade bills at the time. To make sure that the bills were never exchanged for RMs, which would lead to inflation, the ninety-day maturation period for the bills kept being extended until the actual maturation period became five years.¹⁷ Summing up how unethical MeFo bills were, the Russian Nuremberg judge Iona Nikitchenko called them "a swindling venture on a national scale that has no precedent."¹⁸

From 1934 to 1938, the Nazis funded rearmament through 12 billion RMs worth of MeFo bills.¹⁹ These MeFo bills allowed the government to exclude this figure from their official

¹⁵ For an exhaustive account of the MeFo bills system, see Preparata, "The Nazis' Financial Legerdemain," 9–94.

¹⁶ Guido Giacomo Preparata, "Hitler's Money: The Bills of Exchange of Schacht and Rearmament in the Third Reich," *American Review of Political Economy* 1, no. 1 (December 1, 2002): 21.

¹⁷ Christopher Kopper, "Banking in National Socialist Germany, 1933–39," *Financial History Review* 5, no. 1 (April 1998): 59.

¹⁸ International Military Tribunal, *Opinion and Judgement*, 169.

¹⁹ Kopper, "Banking in National Socialist Germany, 1933–39," 59.

expenditure statements (so no inflation could occur) and to circumvent the Central Banking Law, which prohibited the Reichsbank from funding the government.²⁰ Perhaps most importantly, the MeFo bills also allowed the government to hide its rearmament financing from the world until Hitler was ready to reveal it in March 1935.²¹ The Nazis knew that dealing in MeFo bills was a risky maneuver with the potential for immediate collapse and Reichsbank officials hoped that the budget would balance before banks decided to rediscount their MeFo bills.²²

After issuing MeFo bills, the Nazis further financed the recovery by controlling capital markets, which enabled them to co-opt private businesses into funding the rearmament and other desirable, autarkical programs. Instead of nationalizing corporations as the Soviets did, the Nazis provided strong incentives for businesses to invest in Reich friendly programs.²³ For example, the Loan Fund Law of December 1934 capped dividend payments at 6% of reserves and taxed the surplus.²⁴ Whereas the retained earnings of private companies had been 170 million RM in 1933, earnings increased to 3,420 million RM by 1938. Of those reserves, over 62% were reinvested into the economy.²⁵

²⁰ Ibid.

²¹ Schacht, "Unsigned Memorandum from Schacht to Hitler," 2; Hjalmar Schacht, "Correspondence between Schacht and Hitler," January 11, 1939, EC-369, In *Nazi Conspiracy and Aggression*. United States Government Printing Office, 1946.

²² "Affidavit II of Emil Puhl," November 8, 1945, 2, EC-438, In *Nazi Conspiracy and Aggression*. United States Government Printing Office, 1946.

²³ Buchheim and Scherner, "The Role of Private Property in the Nazi Economy," 395.

²⁴ Wolfe, "The Development of Nazi Monetary Policy," 397.

²⁵ Robert Clement Engström, "Nazi War Finance and the German War Economy" (MBA, University of Pennsylvania, 1968), 45.

By 1936, the government also influenced where this capital was reinvested. One method was through the tight rationing and regulation of raw materials. Germany was a net importer of raw materials.²⁶ Therefore the Nazis found it important to reallocate their scarce supply of raw materials through supervisory boards to help rearmament. This reallocation made it hard for companies to get the amount of raw materials necessary to fund their own projects.²⁷ However, the Nazis would release more raw materials for projects deemed important for rearmament or reaching autarky. Thus it became profitable in many instances for companies to pursue the goals of the Reich. As a result, private investment in autarkical industries grew more than seven-fold by 1937.²⁸ Furthermore, even though 42% of that year's GDP growth came from military spending, the private sector's fiscal contribution to said GDP growth was 79%.²⁹ However the Nazis' reliance on the private sector had its limits. Companies still considered the potential for long term profit and it was clear that rearmament could not continue forever. This mentality dictated that they would not produce rearmament goods at as high a rate as the Nazis desired.³⁰

An ancillary effect of increased private reinvestment was that large investment banks lost a considerable amount of business since companies no longer needed industrial loans to finance new

²⁶ Klein, *Germany's Economic Preparations for War*; Tooze, *The Wages of Destruction*, 50; Volkman, "The National Socialist Economy in Preparation for War," 349.

²⁷ Buchheim and Scherner, "The Role of Private Property in the Nazi Economy," 398.

²⁸ Jonas Scherner, "Nazi Germany's Preparation for War: Evidence from Revised Industrial Investment Series," *European Review of Economic History* 14, no. 3 (December 1, 2010): 442.

²⁹ Tooze, *The Wages of Destruction*, 63.

³⁰ Buchheim and Scherner, "The Role of Private Property in the Nazi Economy," 399.

projects.³¹ Consequently, companies became more dependent on the Reich than investment banks because the Reich controlled the imports of raw material that production required. The Nazis' capital controls handcuffed the investment banks and they essentially became depositories for MeFo bills.³² Once the investment banks became disabled, the meaningful supply of money shifted to private savings banks. Again, the Reich took advantage. Despite a 77% increase in deposits, the banks' loans to private debtors surprisingly decreased from 1933 to 1938.³³ For a variety of reasons, the Reich could control these banks' loans more than they could control those of investment banks

There were three main reasons why the Reich reserved the refinancing power of savings banks for itself and why the savings banks could easily be moved by material incentives. First, their structure of long-term liabilities made such banks extraordinarily fit for taking on long-term loans in their portfolios. Although saving deposits were legally short-term liabilities, in aggregate they fluctuated only slightly so that they could be reinvested in long-term loans without risking illiquidity. Second, the Reichsbank recognised Reich loans as liquid assets which meant that savings banks could easily fulfil the liquidity standards of the Reichskommissar für das Kreditwesen [Reich Commissioner for credit

³¹ Kopper, "Banking in National Socialist Germany, 1933–39," 56; Tooze, *The Wages of Destruction*, 110.

³² Engström, "Nazi War Finance," 34; Wolfe, "The Development of Nazi Monetary Policy," 401.

³³ Kopper, "Banking in National Socialist Germany, 1933–39," 58.

business]. Third, the interest paid on Reich loans was significantly higher than that on private bills, which fell from 4.1 per cent to 3.3 per cent.³⁴

Because of these conditions, private savings banks played a large part in refinancing long-term government debt as well as investing in rearmament industries. Their holding of government debt in 1939 was 6.5 times higher than it was in 1933.³⁵ These banks became the third major financier of the recovery after MeFo bills and private corporations.

With such risky methods of financing, the confidence and trust of the parties involved was paramount. The Nazis needed to provide economic stability to keep confidence in their unorthodox methods high. To this end, they instituted strict wage and price controls. Two months after taking power in 1933, the Nazis eliminated collective bargaining rights and unions and replaced them with the Nazi affiliated German Labor Front. The role of this organization was to keep worker morale high through fascist indoctrination and middle class comforts such as vacations, company picnics, and Volkswagens. New laws were passed in early 1934 that gave government appointed labor trustees the power to regulate wages for whole industries.³⁶ The Nazis succeeded in keeping wage rates at depression levels throughout the recovery, which benefitted the recovery by decreasing consumption and freeing corporations to produce more rearmament focused goods through increased earnings that had to

³⁴ Ibid., 57–58.

³⁵ Engström, “Nazi War Finance,” 40.

³⁶ Klein, *Germany’s Economic Preparations for War*, 66; Engström, “Nazi War Finance,” 20.

be reinvested in production per the Loan Fund Law.³⁷ Another advantage was that companies' profits would directly increase as technological improvements and economies of scale decreased production costs. These profits also meant there was more money available for reinvestment.

Despite the wage controls, private consumption had to rise as unemployment decreased.³⁸ As this began to occur, representatives from the Labor Front voiced their concern that workers were unhappy that price increases in consumer goods were not met with wage increases. In 1936 the problem worried the Nazis enough that they created the Office for Price Formation, which audited consumer businesses and told them what to charge for their products.³⁹ Oversight was so strict that the Reich even regulated whether certain hotels could give jam with breakfast.⁴⁰ Naturally, the Nazis granted more profitable price structures to companies that produced more rearmament goods.⁴¹ Harsh punishments for evading the Nazis regulations, including execution, prevented the formation of large black markets. The Office for Price Formation is yet another example of how the Nazis manipulated the free market to encourage businesses to reduce their production of luxury goods and instead focus on goods necessary for autarky. As seen with their control over wages, the Nazis' control over prices proved largely successful; the cost of

³⁷ Overy, *The Nazi Economic Recovery*, 57; Volkman, "The National Socialist Economy in Preparation for War," 290.

³⁸ As more people became employed, money flowed from the government and private businesses to the workers. The workers, naturally, spent some of this money, which meant that private consumption would rise.

³⁹ Engström, "Nazi War Finance," 28; Tooze, *The Wages of Destruction*, 231.

⁴⁰ Wolfe, "The Development of Nazi Monetary Policy," 396.

⁴¹ *Ibid.*, 395.

living was only 6% higher in 1938 than it was in 1933 despite massive economic growth.⁴²

While these internal policies kept the domestic economy stable during the mid-1930s, the stability came at the expense of Germany's foreign exchange reserves. Though the Nazis aimed for autarky, the reality was that Germany needed to import ever-growing amounts of food and raw materials to feed the rearmament economy.⁴³ Germany had always needed to import these resources. However, the loss of territory mandated by the Treaty of Versailles exacerbated the problem, reducing Germany's agricultural capacity 15% for many important crops and its iron ore capacity by 75%.⁴⁴ Shortages in steel, iron ore, copper, and oil could not be met by increased production, necessitating the importation of those crucial war machine materials.⁴⁵ The Nazis' rearmament financial practices and labor laws crowded out investment for exports and consumer goods, which strained German foreign exchange reserves even more to compensate.⁴⁶

Whereas the Nazis' economic policy solutions and financing methods kept domestic confidence high, they sent international confidence in its economy into a tailspin. While Germany's antagonistic general foreign policy no doubt played a role, their financial decisions must be heavily considered in an analysis of their foreign trade weakness. To begin with, a moratorium on foreign debt payments in 1933 and a purposeful

⁴² Ibid., 396; Volkman, "The National Socialist Economy in Preparation for War," 294.

⁴³ Tooze, *The Wages of Destruction*, 50.

⁴⁴ Volkman, "The National Socialist Economy in Preparation for War," 160.

⁴⁵ Klein, *Germany's Economic Preparations for War*, 41–44, 50.

⁴⁶ Bas, "An Austrian Analysis of the Nazi Economic Recovery (1933-1939)," 308; Buchheim and Scherner, "The Role of Private Property in the Nazi Economy," 390; Ritschl, "Deficit Spending in the Nazi Recovery, 1933–1938," 559.

default on these payments in 1934 surely did the Reich no favors.⁴⁷ It was also lost on no one that if the Reich had the funds to rearm, it could surely pay back its foreign debts first.⁴⁸ The effect of this mentality was seen in early 1935 when German bond prices began to steadily decline on the world market until they reached rock bottom once war commenced in September 1939.⁴⁹

It fell to Hjalmar Schacht to minimize Germany's foreign trade troubles. Introduced in 1934, his collection of initiatives was called the New Plan. One such initiative to remedy the Germans' lack of food and raw materials was to pressure weaker countries in Eastern Europe and South America into bilateral clearing agreements with Germany. Per these agreements, trade would be conducted either through barter or, if necessary, in RMs so that foreign exchange-reserves were never used.⁵⁰ By 1938, clearing agreements had been signed with over forty countries, who collectively bought about 80% of Germany's exports.⁵¹ In order to avoid devaluing the RM, Schacht devised a clever bond discounting/subsidy scheme that subsidized German exporters on foreign financial markets.⁵² With this plan, Schacht was effectively able to give exporters the competitive advantage of currency

⁴⁷ Tooze, *The Wages of Destruction*, 72; Albrecht Ritschl, "Reparations, Deficits, and Debt Default: The Great Depression in Germany," in *The Great Depression of the 1930s: Lessons for Today*, ed. Nicholas Crafts and Peter Fearon (OUP Oxford, 2013), 118.

⁴⁸ Tooze, *The Wages of Destruction*, 80.

⁴⁹ Schacht, "Unsigned Memorandum from Schacht to Hitler," 2; William O. Brown and Richard C. K. Burdekin, "German Debt Traded in London During the Second World War: A British Perspective on Hitler," *Economica* 69, no. 276 (November 1, 2002): 655–69.

⁵⁰ "Affidavit I of Emil Puhl," 3.

⁵¹ *Ibid.*

⁵² For further explanation, see: David E. Kaiser, *Economic Diplomacy and the Origins of the Second World War: Germany, Britain, France, and Eastern Europe, 1930-1939* (Princeton: Princeton University Press, 1981), 140–41.

devaluation while avoiding the inherent increases in import prices and the national debt.

However, with the 1935 fall in bond prices, this mechanism became untenable and Schacht told the army that he would not be able to fulfill their rising demand for imported raw materials.⁵³ To remedy the situation, he had to impose a new, large tax on the businesses profiting from the rearmament in order to keep exports competitive.⁵⁴ This tax proved effective; exports rose, allowing imports of raw materials to rise as well. The government used supervisory boards to control the allocation of these imports across the country.⁵⁵ Since these imports primarily went to rearmament (metals) or autarkic industries (primarily food), production of consumer goods decreased. In fact, there was no increase in consumer production from 1934 to 1936 despite the economic growth caused by the recovery.⁵⁶

Schacht had to damage domestic happiness in order to shore up foreign exchange shortfalls. This would hurt the Reich over time as average Germans began to notice that their quality of life had decreased despite the country's theoretical prosperity.⁵⁷ The idea of working for the benefit of the state was not enough to stop workers from asking for promotions, especially once workers knew that unemployment was low, making each one of them more valuable to their companies. To keep wages stagnant, the Nazis passed laws to keep workers in their current jobs and even assert that workers could be reassigned at will to industries with labor

⁵³ Hjalmar Schacht, "Letter from Schacht to Reich and Prussian Economics Minister Concerning Army Demands for Raw Material," December 24, 1935, EC-293, In *Nazi Conspiracy and Aggression*. United States Government Printing Office, 1946.

⁵⁴ Tooze, *The Wages of Destruction*, 92.

⁵⁵ Kaiser, *Economic Diplomacy and the Origins of the Second World War*, 132.

⁵⁶ Tooze, *The Wages of Destruction*, 94–95.

⁵⁷ *Ibid.*, 162–65.

shortages.⁵⁸ The effect was that workers put in less effort and domestic production became less efficient.⁵⁹

As 1939 inched closer and Germany began to annex land to the east, Schacht had to keep rearmament growth high despite an ever worsening foreign trade situation and decreased efficiency at home. The 1938 annexation of Austria provided a much needed infusion of foreign exchange reserves, equivalent to 782 million RM, which doubled Germany's supply.⁶⁰ This allowed Schacht in 1938 to run the largest German trade deficit since 1929.⁶¹ However, the acquisition of Austria actually hurt Germany in the long run because, like Germany, Austria was an importer of food and raw materials.⁶² By the start of 1939, the Austrian foreign exchange reserves were exhausted.⁶³ Schacht had to get more desperate with his foreign trade practices.

Due to the Nazis' policy for years of keeping the RM sheltered from the free market both domestically and abroad, it became increasingly difficult to value as a currency. The countries who had clearing agreements with Germany wanted to trade less with it as a result, instead preferring hard currency countries such as Great Britain.⁶⁴ As Germany's importation needs became ever greater, Schacht began to rely less on clever financial tricks than on outright economic bullying of Eastern European countries. The most extreme case was a one-sided deal with Romania he signed in

⁵⁸ Engström, "Nazi War Finance," 21; Klein, *Germany's Economic Preparations for War*, 66.

⁵⁹ Timothy W. Mason, "The Workers' Opposition in Nazi Germany," *History Workshop*, no. 11 (April 1, 1981): 127.

⁶⁰ Tooze, *The Wages of Destruction*, 246.

⁶¹ *Ibid.*

⁶² Kaiser, *Economic Diplomacy and the Origins of the Second World War*, 245.

⁶³ Schacht, "Correspondence between Schacht and Hitler," 3.

⁶⁴ Kaiser, *Economic Diplomacy and the Origins of the Second World War*, 138–39.

late 1938.⁶⁵ Romania had to accept German arms exports in exchange for foodstuffs, oil, and other materials the German economy needed. This deal so strained Romania that they had to import raw materials themselves to keep up with the German demand.⁶⁶ It is interesting to note that Poland, the first victim of the German blitzkrieg, was one country that held its ground and refused to make a trade deal with Germany.⁶⁷

Despite Schacht's efforts, Germany was unable to keep up with its import demands and Hitler dictated that the shortages hit normal Germans instead of hindering the rearmament effort. In an urgent letter written in January 1939, Schacht told Hitler, "Especially in the field of *daily requirements* for the home and clothing, the lack of supply and above all the decline of quality is most evident."⁶⁸ The analysis of labor historian Tim Mason puts it best

The whole economic system was so strained that any one hold-up immediately caused another. These multiple shortages, which constituted a kind of negative multiplier effect, were the chief distinguishing mark of the situation just before the outbreak of war... it was a general economic crisis.⁶⁹

The confidence of the people and the confidence of businesses and banks was what the Reich, by necessity, valued most. Even though

⁶⁵ Ibid., 265.

⁶⁶ Ibid., 269–70.

⁶⁷ R. J. Overy, "Germany, 'Domestic Crisis' and War in 1939: Reply," *Past & Present*, no. 122 (February 1, 1989): 228.

⁶⁸ Schacht, "Correspondence between Schacht and Hitler," 3.

⁶⁹ Timothy W. Mason, *Nazism, Fascism and the Working Class* (New York: Cambridge University Press, 1995), 116.

there were food and import shortages, they were never so severe as to put the country at risk of starvation. Having enough food to eat was not the point; confidence in the Nazis was. The Nazis were frightened by how shortages may affect the public morale; a shortage would alert the average German to the frailty of the economy, which would damage support for the Nazis.

While the supply shortage of early 1939 caused the working class to lose confidence in the Nazis' economic prowess, MeFo bills did the same for businesses and banks. The MeFo bills that jumpstarted Germany's miraculous recovery also threatened it the most. In March 1938, Schacht ended MeFo financing because he felt the system had gotten out of control.⁷⁰ Finally Schacht had found a predicament from which he could not slither out. Many MeFo bills were also reaching maturity and the Reichsbank had to pay back the bills' worth to their holders. But Hitler wanted to continue financing rearmament to the fullest. Schacht tried to sell long-term bonds to MeFo bills creditors instead of giving them hard cash, but they would not buy.⁷¹ His only recourse was to print money and run a deficit. But the rearmament campaign still demanded money as well. To plug this hole, in October 1938, Schacht tried to sell four packages of long-term bonds to the public, each containing 1.5 billion RM. Surprisingly, private savers and insurances funds bought the first three packages but the fourth one suffered a massive failure in late November after Schacht introduced it.⁷² The financiers of the Nazi economy had lost confidence a couple of months before the workers did at the start of 1939.

⁷⁰ Tooze, *The Wages of Destruction*, 253.

⁷¹ Ritschl, "Reparations, Deficits, and Debt Default: The Great Depression in Germany," 120.

⁷² Tooze, *The Wages of Destruction*, 295.

The result was that Schacht had to increase the money supply and run up a massive deficit to counterbalance the loss in capital and keep the rearmament going. From the start of Hitler's reign to the end of MeFo bill financing, the amount of RMs in circulation rose from 3,560 million to 5,278 million. But from March to December 1938, currency circulation rose to 8,223 million RMs, effectively rising more in ten months than it had in the previous five years.⁷³ The deficit likewise rose enormously in this time though it had been increasing at a healthy pace previously. Schacht told Hitler that spending on the military would have to be cut or incredible inflation would ensue.⁷⁴ Instead of listening to Schacht, Hitler fired him, electing to replace him with a loyal deputy named Walther Funk.⁷⁵ Hitler instructed Funk to get prices, wages, and the foreign trade debacle under control using whatever means necessary.⁷⁶ A short, obsequious letter written by Funk to Hitler regarding the status of the economy in mid-1939 highlights the stark difference between Funk and Schacht as protectors of the German economy; Funk would do whatever Hitler demanded, regardless of the havoc it would wreak.⁷⁷ In June 1939, Hitler also abolished the Reichsbank limit for adding to the money supply, officially taking Germany off the gold standard it had speciously claimed to be on since the end of World War I.⁷⁸ After that, Funk instituted a war rationing system that gave the government draconian control over consumer goods with the justification that Germany was, or soon would be, at war. Funk's

⁷³ Schacht, "Correspondence between Schacht and Hitler," 5.

⁷⁴ *Ibid.*, 8.

⁷⁵ James, "Schacht's Attempted Defection from Hitler's Germany," 731.

⁷⁶ Overy, "Germany, 'Domestic Crisis' and War in 1939," 227.

⁷⁷ Walther Funk, "Letter from Funk to Hitler, Reporting on Economic Affairs," August 25, 1939, 699-PS, In *Nazi Conspiracy and Aggression*. United States Government Printing Office, 1946.

⁷⁸ Tooze, *The Wages of Destruction*, 299.

actions signaled a shift to the wartime economy that would generally dominate the Nazi state until its collapse in 1945.

Taken as a whole, the Nazi economic recovery of the 1930s was like a balloon. The Nazis tried to fill the balloon with air but they could never tie the knot to keep it stable. Their choice was either to stop pumping air and let the balloon fizzle away or to keep pumping until it popped. The evidence indicates that they chose the latter. The Nazis' call for immediate economic growth led to financing practices that produced massive short term gain with equally as massive long term consequences. The success of their policies regarding MeFo bills, the co-opting of the private sector, and the regulation of wages and prices all rested on domestic trust and confidence. While Germans trusted their economy for some years, the rest of the world, operating mostly on a free market basis, was skeptical. For an economy that relied heavily on imports, this was fatal. To prevent a total collapse of Germany's foreign trade position, the Nazis had to make sacrifices that damaged domestic confidence. Eventually, these sacrifices became so great that confidence in the German economy faltered both domestically and globally, leading to an unstable economy by 1939.

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