

HORACE GREELEY HJALMAR SCHACHT

(And the Magical Mystery MEFO Bill)

In 1872, the German immigrants William Schacht and Constanze Eggers married in New York City. Herr Schacht suffered from both homesickness and a certain fascination with an American newspaperman and political figure. So, when his second son was born in North Schleswig five years later, the babe received the weighty name of Horace Greeley Hjalmar Schacht.

Forty-six years later, the mature Hjalmar – together with his doctorate in philosophy – assumed the German titles of Commissioner for National Economy and President of the Reichsbank. No other philosopher would have done so because Germany in that year remained completely ensnared in the most famous and relentless hyperinflation of all time. The money required to buy one egg in 1923 could have purchased 500,000,000,000 eggs five years earlier. The desperate scheme to invent a currency that entitled the bearer to a certain amount of rye (the grain, not the whiskey) had come to nothing. The situation was hopeless before Dr. Schacht stopped the inflation dead in its tracks.

The mechanisms Schacht employed are certainly crucial, but, for present purposes, we consider the all-important issue of personality. Young Hjalmar began his banking career as a public relations functionary and soon allowed his fascination with the overall structure of banking to get the better of him. He volunteered his free time to apprentice himself in every niche of the financial enterprise, from clerk to bookkeeper to loan officer. The overarching lesson of this education was that money men fall into two categories. There are free-wheeling gamblers who speculate, and there are trustees whose stewardship and strict adherence to prudent policies guarantee stability. No collar or backbone was more stiff than that of Horace Greeley Hjalmar Schacht. To quote but one of his principled positions:

“The introduction of bank-notes or Government paper currency has been made feasible only because the State or the Central Bank has promised to exchange the paper money for gold at any time. To ensure this possibility (i.e. the redemption of paper by gold) at any time must therefore be the aim of all issuers of paper currency. Any State or Central Bank who deliberately or carelessly flings away this possibility is guilty of a crime against its citizens. Were a private individual to do so he would be branded a defaulter and a cheat.”

So how does such a staunch and proper gold bug confront the dilemma of a nearly worthless currency? The essence of German hyperinflation was that it yielded enormous profit to a class of cognoscenti with easy access to credit. This was not a gang to be trifled with, and neither was the political and business crowd frantically printing their own emergency notes to add to the flood of paper. As sheriff, Dr. Schacht confronted a powerful mob of speculators and printers foaming at the mouth. Amid howls of protest and personal attacks, he simply closed the

credit window at the Reichsbank and refused to exchange private or municipal paper for the official Reichsmarks. Within the space of one month – November of 1923 – the game was over.

Late in life, Dr. Schacht wrote two versions of his autobiography. In *The Magic of Money* and *Confessions of the Old Wizard*, he emphasizes, time and time again, his heartfelt compassion for the average citizen. The modern reader comes away with a faith in Schacht's sense of personal responsibility for safeguarding the prosperity of all those dependent upon sound money and a functioning economy. He provides no detail on his Masonic membership, but we're allowed the clue of the poem he wrote as the opening for *Confessions*:

*Neither violence nor power of the purse
Fashion the universe.
Ethical action, spiritual force
May reshape the world's course.*

This is, quite naturally, the perfect opening scene in the classic tragedy that unfolded in 1933. We have the traditional protagonist driven entirely by unbending moral obligation and the hubris of certainty that only he possesses the necessary monetary wizardry. From the prologue, he is surrounded by fools, ideologues, cheats, and self-seekers, and never once has he blinked in the face of any such nonsense. Yet, in 1933, the world lay in financial ruin. One in three German workers sat unemployed, and none of the traditional economic quackery had been the least bit effective. Just as Greek princes once recruited Odysseus, the German government lured the great Schacht out of retirement and once more crowned him as king of the Reichsbank. None of his earlier engagements with idiots could prepare our hero for the ultimate nincompoops of Adolf Hitler and his bedlam of associates. Schacht had no illusions about his new employer, but neither did he fail to understand the absolute necessity of rescuing a nation in the depths of despair. Schacht and the devil came to terms, and *The Magic of Money* offers this account of an early conversation:

Hitler: Herr Schacht, I am sure we are agreed that at the moment there can be only one urgent duty for the national Government, and that is to do away with unemployment. For this it will be necessary to find a very large sum of money. Do you see any possibility of raising such a sum – other than through the Reichsbank?

Schacht: I agree with you entirely, Chancellor, that it is essential to wipe out the unemployment figures. But no matter what money can be extorted from other sources, it would still be quite insufficient for the job. You won't be able to avoid recourse to the Reichsbank.

Hitler: Have you any general idea of the amounts involved? ...Surely you must be able to say to what extent the Reichsbank can – and must – help.

Schacht: I am honestly not in a position, Chancellor, to mention any particular sum. My opinion is this: Whatever happens we must put an end to unemployment and therefore the Reichsbank must furnish whatever will be necessary to take the last unemployed off the streets.

And that's exactly what he did. By 1936, while the United States was toying with deficit shovels, Germany had bulldozed its way to full employment. Every single citizen who wanted a job had one. So what voodoo had the magician performed?

Central banks, such as the Reichsbank and our Federal Reserve, are forever straddling the razor wire between public and private interests. Traditionally, they exist to render aid and comfort to the commercial banking system whose members are constantly engaged in shenanigans that threaten to bring down the whole shebang. A central bank oversees the whole machinery of capitalist money creation via the bizarre fractional reserve system that we'll discuss in other essays. However, the money factory was also created to finance royal hobbies, those being almost entirely wars. In these cases, the financing could either come as loans floated from existing reserves, or it could be pulled from thin air as paper money, better known as fiat money or "money by declaration". As with any tragedy, heads in the audience begin to swim, and now is neither the time nor place for a full examination of the two varieties of legal tender.

Returning to the specifics of Act Two of our drama, Schacht authorized the Reichsbank to loan the government one billion marks for public works in the repair of houses, factories, and machines. He then doled out another 600 million for highway projects. There is absolutely no reason to believe that the Reichsbank had 1.6 billion in its vaults. Nor were such pre-existing sums required. When any government places an order for goods and services, it immediately transcends the bounds of capitalism, and Germany's autobahns paved the way for the instant creation of new money. The "loans" were never repaid, by the way, nor should they have been.

Two subplots are also crucial in these theatrics. While Schacht was busily printing the right amount of money, he was also going toe-to-toe with the mob from the palace of Versailles. The reparation payments demanded of Germany following the First World War were insane (and the direct cause of Nazi success), and Schacht finally got the message through certain remarkably thick skulls. The demands for tons of flesh ceased. He also confronted the problem of how to finance trade with raw material and food suppliers in Eastern Europe amidst the devastation of world credit supplies. It turns out that bilateral money can be a few well-placed book entries.

So far, so good. As of 1934, all of Schacht's schemes were operating properly, and there was every reason to believe that the return of prosperity would also usher in the liberal democratic government that would return Hitler to a Bavarian obscurity. But all sovereign nations need to defend themselves, do they not? Even now, is it not our patriotic duty as Americans to cough up more than \$700 billion a year for "defense" and so-called intelligence? Where would we be if we didn't outspend the combined efforts of our thirteen closest allies/competitors? So the turn of the tragic screw began when Hitler presented Schacht with the logical demands of rebuilding the protective national shell. The audience screams, "Don't open that door! No, not that one!", but to no avail.

What happened next remains deeply mysterious. For all intents and purposes, it seems perfectly logical that Schacht would continue to open the floodgates of Reichsbank notes just as he'd done with the public works initiatives. Why do anything else? If it weren't for the hubris...

The following italicized paragraphs are quoted from *The Magic of Money*, but the reader should be forewarned that any detailed discussion of the nature of money produces a remarkable glazing of the eyes.

“The third method was the defence programme. The building of barracks and the equipping of troops brought orders to concerns spread over the entire country. As the cost of this part of the programme to secure employment for everyone was so great and the repayment period so long, the method by which credit was granted directly to the Reich could not be used here. There was too great a danger that the Reichsbank, in granting direct credit, would lose control of currency policy. A way had to be found which would ensure that the Reichsbank was able to restrict and limit the amount of money in circulation. It took us in the Reichsbank a year and a half to find a system which was suitable, and would still enable us to pursue a responsible currency policy. The provision of money for defence did not therefore begin until the late summer of 1934.

“The system worked in the following way: a company with a paid-up capital of one million marks was formed. A quarter of the capital was subscribed by each of the four firms Siemens, A.G. Gutehoffnungshutte, Rheinstahl, and Krupps. Suppliers who fulfilled state orders drew up bills of exchange for their goods, and these bills were accepted by the company. This company was given the registered title of Metallforschungsgesellschaft (Metal Research Company, ‘MEFO’ for short), and for this reason the bills drawn on it were called MEFO bills. The Reich guaranteed all obligations entered into by MEFO, and thus also guaranteed the MEFO bills in full. In essence all the Reichsbank’s formal requirements were met by this scheme. It was a question of financing the delivery of goods; MEFO bills were therefore commodity bills. They rested on a threefold obligation: that of a drawer, an acceptor, and the Reich. This provided the Reichsbank with every justification for discounting the bills, and, although it was put to every test by the Reichsbank’s directorate in collaboration with the country’s best legal brains and economists, they agreed unanimously that it was valid.

“...The Reichsbank undertook to accept all MEFO bills at all times, irrespective of their size, number, and due date, and change them into money. The bills were discounted at a uniform rate of four percent. By these means, the MEFO bills were almost given the character of money, and interest-carrying money at that. Banks, savings banks, and firms could hold them in their safes exactly as if they were cash. Over and above this they proved to be the best of all interest-bearing liquid investments, in contrast to long-dated securities. In all, MEFO bill transactions took place over a period of four years, and had by 1938 reached a total volume of twelve billion Marks. This amount was not issued all at the same time, but in step with the progress in production. On average, bills to the value of three billion were issued each year. Whether this was the right amount, whether more or less was to be issued, depended on the currency policy the Reichsbank decided to pursue. The politicians had different ideas. They wanted the highest

possible number over the longest possible period. After a hard-fought battle, the decision went in favor of the Reichsbank.

“...When the MEFO system was introduced I fully expected that the revitalization of the economy would result in such progress in the growth of incomes and in capital formation that repayment would be made possible by growth in taxation yield together with loans. This expectation was not only realized in full, it was also widely exceeded. In the years between 1933 and 1938 the Reich’s income from taxation rose by over ten billion Marks. In the same period I succeeded in placing no less than eight billion in Reich loan stock with the general public.”

Schacht’s recounting here contains a number of technical references centered on the words “bill” and “discounting”. I leave it to the reader to pursue the mechanical details to his or her heart’s content, while I confess to a high degree of mystification and indifference. The actual specifics of how MEFO bills changed hands takes a back seat to the overarching fact that Schacht resorted to paper money and did it through a bizarre stratagem so far removed from gold it’s not funny. The Metal Research Company?!!!!

The true insight into the MEFO phenomenon comes with Schacht’s reflections on the full scope. He begins with a colossal whopper of understatement:

“It is true that the system was novel in some of its essential aspects, and that it lay outside the normal sphere of activity of a currency bank...”

Presumably, he said this with a straight face and then continued:

“The MEFO system was a noteworthy example of the fact that it is possible to make up for a lack of capital by means of credit without any risk of engendering an inflation which cause price rises. The stability of the currency remained assured. The risk of the whole process lay in two directions. Had it not proved possible to arrange things in such a way that a large part of the issued bills would be retained by the market and thus not presented to the Reichsbank, then an excessive use of the bank-note printing presses would have been unavoidable. This danger was avoided by making the bills rediscountable at any time, and by paying four percent interest on them. The second danger lay in the eventuality that production might not have increased to a degree where it would yield a greater quantity of material goods and higher taxation revenue. Both dangers were foreseen, both were forestalled.

“But the conditions under which the scheme can be applied without disadvantages are not always present. They were indeed present in Germany during the depression of the thirties. Then there were no more stocks of raw materials, factories and warehouses lay empty, machines were idle, and six and a half million willing men were unemployed. Liquid capital savings which could have been invested were not available. Production was restricted to such a degree that accumulation of capital could not take place. If rapid capital formation was once again to become possible, the powerful but stagnant productive resources had to be brought back into operation. The capital that could be expected to result from such developments was used in advance to grant credit through the MEFO transactions. Had the productive activity which was initiated by means of this credit gone awry the MEFO experiment would have proved a failure.

Then the money which had been printed would not have been balanced out by capital formation, but would have led to inflation.

“...The MEFO bill system was not and could not be a perpetuum mobile. As soon as full employment had been reached every further granting of credit could only lead to an excess in the circulation of money, and to a rise in the price level, and thus to inflation. This had to be avoided at all costs.”

The seeming conclusion of Schacht's eventual downfall is that, by 1938, he understood that full employment demanded the winding down of the MEFO hocus-pocus. And if the military aspirations were simply defensive, that objective was close at hand. So, when Hitler threw a tantrum and demanded still more cash for guns, Schacht dug in his heels, was promptly dismissed and eventually wound up in the concentration camp at Dachau. He was tried by both the Nuremberg court and the post-war de-Nazification tribunals, served some time, and returned to life as a private citizen and occasional financial advisor. The true denouement would come later.

The great danger in this recounting of the Schacht saga is that the mechanisms of the MEFO system are so intriguing and baffling, we become lost in them. The one detail that leaps from the page is the infinitesimal mention that Schacht needed eighteen months to work out the design. It's my personal suspicion that the difficulty lay not in the technical aspects but in the psychological. Remember that we're dealing with a staid, fastidious personality who put his heart and soul into that early reverence for gold. Then, following hard on the heels of dabbling with ink, he ran headfirst into what must have seemed a surreal violation of all traditional wisdom. Einstein attributed his vision of relativity to his youthful fantasies of riding a photon, and Schacht must have experienced a similar epiphany. The hard numbers and precise equations came only after a certain amount of soul-searching. Even now, when money does in fact move at the speed of light, the comprehension of its elusive nature remains a challenge to every preconception we hold near and dear.

Yet, this can't diminish the importance of technical eloquence. The printing of fiat money comes with two demons attached.

Schacht's MEFO genius stemmed from the direct injection of money into the productive, industrial side of the economy. But the newly minted money may be easily diverted. The basic problem with capitalism is that bankers always have a choice. They can loan money to currency speculators whose gambles yield spectacular windfalls, or they can ante up for irrigation systems in Botswana. The casinos always win, the bubbles erupt, and the whole mess goes to hell in a hand basket. Even though the MEFO bills could be redeemed for cash at the Reichsbank, they were structured in such a way as to prove most useful in large transactions among colossal corporations. They remained within the confines of coal operators, steel-makers, and manufacturers. But is the military-industrial complex truly "productive" in any meaningful sense of the term? And weren't the MEFO drugs impossibly addictive to a fascist personality like Hitler's? The agonizing irony of the issue is that America's militarization for the Second World War was undoubtedly an effective medication. When the sons and daughters of share-

croppers become agricultural scientists, prosperity happens. And then it goes horribly wrong, for Schacht, for Eisenhower, and for us all.

The second pestilence of printed money is that the financial universe combines two tiers. There is the reality of what “is”, and there’s also the world of perception and belief. With our mothers’ milk, we imbibe the belief that inflation results from too much money chasing too few goods. We then read government estimates of a declining corn harvest in Nebraska, and we know, with perfect certainty, that the price of corn will rise. We race to the global marketplace and bet the bank on corn futures. Sure enough, the price reaches for the skies. Was the actual cause the lack of rain or our blind faith in market forces?

Schacht then, when considering all the ramifications of money creation, had to take into account the pious opinion of the omniscient Market. Once the rumors spread that Schacht had gone mad with the printing press, all the high-rollers would trade Marks for Sterling (or hog bellies), the German currency would devalue, and there’d be hell to pay. The necessity then was to devise a special currency that didn’t look like the real thing. It would also be convenient to invent a form of money that was incomprehensible to mere mortals, and, in that, Schacht rose to the greatest heights of pure genius.

Yet, it’s this secrecy, this obfuscation, this sleight of hand that constitutes the legitimate tragedy. By the early ‘30’s, Schacht had come to understand that world prosperity depended upon the immediate development of impoverished nations. Only when the poorest of the world’s poor emerged from destitution could there be the free flow of aspiration that sustains any economy. Schacht’s early proposal of such a strategy resulted in the Bank for International Settlements and then the World Bank as the cruelest of all possible jokes.

Given this realization that prosperity can only exist as a global phenomenon, why then did Schacht not burst from prison as a firebrand evangelist for revolutionary money? Why did this Wizard of Oz not reveal the essence of his machinery at the top of his lungs? It’s my personal belief that two considerations combined to restrain him. He was, from beginning to end, an elitist who believed that printed money would be catastrophic if not administered by an aristocracy of illuminati. Until it had been thoroughly reformed by “ethical action, spiritual force”, the world was simply not ready to learn the necessary lessons. And secondly, if the logic of MEFO bills is carried through to its conclusion, the entire mindset of capitalism dissolves into lunacy. Fiat money belongs in the universe of cooperative, socialist cultures. Yet, Schacht’s era was one of Stalinists, anarchists, trade unionists, and ideologues with whom he could find not a single kindred spirit. The idea that Schacht would ever proclaim, “I am a socialist”, is preposterous, and it’s this retreat from the brink, this failure of nerve, that consigns him to obscurity within the bourgeois behemoth.

Until now.