

# **THE ECONOMICS OF REPARATION**

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The economics of reparation by J. A. Hobson

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## FOREWORD

As a result of the International Conference held in London in November 1920, at the instance of the Fight the Famine Council, a Peace Revision Committee was formed, of which I was appointed Chairman. The material and arguments presented here were originally intended for submission to this Committee, but the difficulties and delay of communication with foreign members were such as to induce me to publish it under my own name and upon my sole responsibility as a contribution to the discussion of a matter which vitally concerns the peace and economic recovery of Europe.

J. A. H.

*June 21, 1921.*

*First published in 1921*

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# The Economics of Reparation

## I

### REPARATION IN THE VERSAILLES TREATY

THE pre-armistice agreement under which Germany laid down her arms in November 1918 contained the following provision for reparation :

“The President declared that invaded territories must be restored as well as evacuated and freed. The Allied Governments feel that no doubt ought to be allowed to exist as to what this provision implies. By it they understand that compensation will be made by Germany for all damage done to the civilian population of the Allies and their property by the aggression of Germany by land, by sea, and from the air.”

When the question came up for settlement in the terms of the Versailles Treaty, Mr. J. F. Dulles, addressing the Supreme Council on behalf of the American delegates, recorded their judgment that

The foregoing language constitutes, in so far as reparation is concerned, the terms upon which the United States and the Allies agree to make peace with Germany and the terms upon which Germany accepted the armistice on November 11, 1918.

To this category of reparation the American delegates added another, not expressly laid down in the Wilson declaration, but held by them to be inherently right and unaffected by those declarations, viz. that “Reparation is due for all damage directly consequent upon acts of the enemy clearly in violation of international law, as recognized at the time of the commission of the acts in question.” How much would have been added to the sum of reparation by such compensation, properly assessed before an impartial international tribunal, and offset by any similar compensation for violation of international law that may have been committed by Allies, it is of course impossible to compute. But it may be held certain that any assessment of these two sorts of



reparations (or probably of the first alone) would amount to a sum at least equal to Germany's total ability to pay, as determined by any fair consideration of her available resources.

The Americans, however, held that the proposal, pressed by the British and the French delegates, for the inclusion in reparations of the entire "costs of the war," as distinct from these defined damages, was a plain violation of the pledge of the pre-armistice agreement. Those who agreed to the case for the extension, relied (in particular the French) upon the terms of the armistice agreement of November 11, 1918, which contained clause 19, opening thus: "With the reservation that any future claims and demands of the Allies and the United States of America remain unaffected, the following financial conditions are imposed: Reparation for damage done." This general reservation, made subsequently to the pre-armistice arrangement, they contended, left the Allies free to present any claims for reparation they thought fit. The American rejoinder to the effect that the armistice terms were "A military document, designed only to ensure the Allies being in a position to enforce the peace arrangements previously entered into," and in nowise competent to modify or over-ride the earlier agreement, was for some time not accepted by the members of the Supreme Council who stood for the inclusion of "war costs." Nothing short of the instruction of President Wilson that the American delegates should dissent "and, if necessary, dissent openly" from a procedure "which is clearly inconsistent with what we deliberately led the enemy to expect and cannot now honourably alter simply because we have the power,"<sup>1</sup> stopped the Supreme Council from this flagrant violation of their pre-armistice pledge. But, formally bowing to the American protest, the other members of the Council reinstated a large section of their claim under the head of "actual damage." For in Article 232 of the Versailles Treaty we read: "The Allied and Associated Governments, however, require and Germany undertakes, that she will make compensation for all damage done to the civilian population of the Allies and Associated Powers and to their property during the period of the belligerency of each as an Allied or Associated Power against Germany by such aggression by land, by sea, and from the air, and in general all damage as defined in Annex 1, hereto." Now while the body of this clause conforms to the pre-armistice agreement, its tail contains violations as patent and almost as substantial as that of the proposal to include the entire "war costs" under reparations. For, on turning to Annex 1 we find the whole of

<sup>1</sup> Baruch, p. 25.

“pensions and separation allowances” brought under reparations on the ground (adduced in a memorandum by General Smuts) that they came under the head of “damage to the civilian population of the Allies in their person and properties which resulted from the German aggression.” Now any reasonable reading of this Smuts memorandum makes it evident that it validates the full French claim for including the entire cost of the war, and that its logic involves that the whole of the Allied war expenditure met by taxation and loans, including the interest hereafter to be paid in all war-borrowing, should form a claim for reparation.

“What had really happened,” writes Mr. Baruch, “was a compromise between the Prime Minister’s pledge to the British electorate to claim the entire costs of the war, and the pledge to the contrary which the Allies had given to Germany at the Armistice.”<sup>1</sup>

But this extension of the pre-armistice reparations to include pensions, allowances, and other *indirect damages* to civilians, by no means exhausts the violations of the earlier agreement, contained in Annex I. The provision that Germany shall be responsible for the reparation in respect of civilian damage done by her Allies is equally indefensible. This illicit extension of the claim on Germany was doubtless due, in part, to the fact that the other Allies could not be regarded as capable of any financial reparation, in part, to the desire of certain representatives of the Allies to load on to Germany a completely crushing burden of indemnity.

The failure to fix the total amount of reparation Germany was called upon to pay was an almost necessary implication of these violations of the pre-armistice agreement. Difficult as was the task of assessing fairly the material damage sustained by the inhabitants of the invaded areas, by partial commissions naturally sympathetic with the sufferers and therefore lenient in their scrutiny of claims, an approximately correct estimate of this damage might have given a sum admittedly within the capacity of Germany to pay. The addition of these vast new obligations of unfathomable magnitude rendered it virtually impossible to reach a figure measuring the total damages for which reparation should be claimed. Any such figure would be recognized as of purely speculative value and its magnitude might have been such as to evoke that reasonable scrutiny of Germany’s “ability to pay” which it was deemed politically expedient at this stage to postpone. For, as will presently be shown, any serious attempt to check the “costs” or “damages” basis of reparation, by this consideration

<sup>1</sup> Baruch, p. 157

of capacity to pay, would have exposed the Allied statesmen to the charge of having wilfully deceived their peoples in holding out the expectation of such indemnities as would relieve their taxation and restore their national finance.

This exposure could only be averted, or postponed, by a refusal to name a fixed sum for reparation. This course was adopted by the Supreme Council, and their Reparation Commission, which, while prescribing definite sums to be paid at intervals within the following years, postponed until May of 1921 the declaration of the aggregate sum and the conditions, in time and in kind, of its payment. The Reparation Commission provisionally arranged that, while the ultimate amount to be paid should be left unsettled, four large separate payments should be made by Germany at named dates, in the shape of gold-mark bond issues.

The first issue was of £1,000,000,000, payable on May 1, 1921, without interest.

The second was to cover Belgium's war costs, and was expected to amount to £800,000,000 due May 1, 1921.

The third series amounted to £2,000,000,000, bearing interest of  $2\frac{1}{2}$  per cent. from 1921 to 1926, and 5 per cent. hereafter, with 1 per cent. for sinking fund. This would retire the bonds by 1951.

A further series of bonds for £8,000,000,000 was to be issued on some unnamed date, provided that the Reparation Commission decided that the obligations for interest and sinking fund which it involved could be met.

Further issues of unnamed amounts might be authorized by the Commission from time to time. This course they took, though warned of the double damage it entailed (1) in sapping the incentives to industry and saving in Germany and increasing her difficulties of procuring outside raw materials and credit, (2) in enabling and inducing Allied statesmen to postpone the "day of account" with their peoples and thus encouraging extravagances of expenditure and deficiencies of taxation based upon the false pretence of huge indemnities from Germany. Financiers and economists, whose advice was sought but not followed by the Supreme Council, appeared to have been unanimous in holding that (1) the real basis for computing reparations was Germany's capacity to pay, and (2) that fixing a reasonable indemnity without delay was advantageous to "capacity to pay"! They differed, however, very widely in their estimate of "capacity to pay," varying in the figures which they gave from some 2,000 million sterling to 25,000 millions.<sup>1</sup>

If the strict interpretation of the pre-armistice obligation had

<sup>1</sup> Baruch, p. 46.