Berlin, Germany, April 13, 1934.

Dear Mr. Phillips:

You have by this time my letters of March 24 and March 29 with regard to the situation here, and I hope that you or Moffat have been able to go over my confidential despatches Nos. 1964 of March 22 and 1970 of March 28. In these and in my letters to you, I attempted to set forth some considerations which I thought might be of interest in connection with the drive which the Germans are making and will make to get us to help them out of the really desperate situation in which they find themselves. In the closing paragraph of my despatch No. 1970, I said that under existing circumstances it is exceedingly difficult to see how we can have any assurance that any agreements which may be entered into between us and Germany, can be carried out or will be carried out from the German end, as the formal assurances of the German negotiators or of the present German Government would not be enough. The secondary leaders are in definite control of the situation yet, and the Government is not in a position to carry out any action in the economic or industrial field against their wishes.

I have been giving these questions the closest attention since I wrote you the foregoing letters and despatches and may say that all that I have heard and all that has developed confirms the background information which I have endeavored to give you. There is increasing concern and real alarm among the upper leaders in the Government and the Party who feel that collapse is inevitable without help from the outside, and they look to us for that help. The initial confidence of some weeks ago that we were so eager to make some arrangement to get rid of raw materials that we would make
make almost any kind of a bargain no matter how disadvantageous to us, has cooled considerably; but we are still the main hope. After reading Dr. Schacht's proposal which White transmitted to the Department with his confidential despatch No. 681 of April 5, I think even the most optimistically and favorably inclined among us must realize that the Germans have nothing to offer and that we have nothing to gain but on the contrary much to lose through any arrangement which can be envisaged at this time.

The economic and financial situations here are becoming steadily accentuated and more serious and an understanding of the consequences is becoming more widely appreciated in banking and business circles which realize all the consequences which must grow out of the inevitable developments in this situation in the next months. This is extremely important from the political point of view as it means that the Government and the Party are losing rapidly the confidence and the support of responsible elements in the country. When the Party came into power in March, 1933, the principal people in the business and the financial world who feared the social and economic program of the Party, gave the Party no support even though they could not oppose it. When after the withdrawal from the Disarmament Conference and the League the political program of the Party was put to the foreground and the leaders shelved for the time being the radical social and economic program in order to then save the day, a very considerable number of the leading German business men and financiers became infected with the general psychology because they were in complete accord with this policy of reasserting Germany's place in the sun. They hoped, and some believed, that the Government and the Party were sufficiently strong to control the secondary leaders so wedded to their radical ideas. Now these men are beginning to realize what I have tried to emphasize in my despatches and letters, that the power lies in the secondary leaders who remain as radical as ever and whose ideas are definitely alienating the world from Germany.
Germany and bringing about financial and economic
distress in the country.

The unfavorable export balances for the last
published months accomplished more than any one
factor in emphasizing the failure of the program
of the new regime. The merchants in Hamburg and
in Bremen who best feel the business pulse of the
country, are almost in a state of panic. Manu-
ufacturers who for years have been having a fair
volume of foreign orders on their books, now
realize the definiteness of Germany's isolation
which they realize will be increasingly reflected
in future export figures. The establishment of
the import monopolies on cotton, wool, copper,
hides, etc., and the further cut in the exchange
made available to importers of all classes of goods,
have emphasized and made definitely clear to an
ever larger number of people in the country the
seriousness of the financial situation. These same
people are also in a position to read intelligently
and to interpret properly the budget figures of the
Government recently published. There has been a
general impression that the internal finances are
in a fair condition; but the budget published shows
that although nominally in balance, there are items
amounting to 700 million marks which to say the
least present little opportunity for realization.
I will not give any details in this respect because
a special report is being prepared on this by Miller,
the Acting Commercial Attache, which will be particu-
larly interesting and which I will bring to the
Department's attention when it is completed. The
The banks are loaded up with the notes of the
Government financing the "Arbeitsbeschaffung" program
which together with the rearmament program is respon-
sible for the increase in industrial activity in the
country.

The net situation, therefore, is as I have al-
ready brought out in my letters of March 24 and 29,
that for the first time since the new Government
came into power the leaders in the Government and
in the Party are tremendously disturbed and some of
them almost in a state of panic. Internally the
increasing dissensions in the Party, the increasing resistance to the church program and the high cost of living accompanied by decreasing instead of increasing family income, are the disturbing factors. The Government talks bravely of reducing taxes and is reducing certain taxes, although the budget has a 700 million mark hole in it. Externally they are faced by practically complete political isolation, with increasing need of raw materials and with the Reichsbank in a very critical position and exports definitely falling. All the available expedients to prop up the foreign exchange and the competitive power of German goods abroad, have been either exhausted or are approaching the end.

Perhaps no one realizes the desperate situation better than Dr. Schacht, for in spite of his peculiar temperament and certain personal characteristics which do not appeal, he is a clever banker and understands the German situation thoroughly. He misjudges the situation in foreign countries and like so many Germans, does not understand properly the psychology of other people. His pride and extreme self-confidence and in a way his arrogance as well as his habit of underestimating the capacities and understanding of foreign bankers and businessmen, particularly our own, lead him into mistakes. But he does realize the gravity of the situation and the practical hopelessness of getting out of it unless the present German Government changes its attitude on certain fundamental questions entirely.

I am informed confidentially but very reliably, that about two weeks ago Dr. Schacht placed before Mr. Hitler a five page memorandum couched in very plain and in what my informant characterized as "sharp" language, in which he stated boldly that the general financial situation of the country and particularly the exchange situation, were such that economic disaster was only a question of months and that it would carry with it the complete destruction of the structure of the National Socialist Party set up within the last year. I am told that he gave in this memorandum five fundamental changes which would have to be made in the attitude of the
Party if disaster was to be averted for it and the country. Of these I could learn only the two first. The first was that the anti-Semitic policy of the National Socialist Party and through it of the Government, must be radically and definitely altered. The second was that foreign interests in Germany of all kinds must be given adequate protection and chance to live and work and that the autarchic attitude of the Government and the Party must be radically altered. I am told that in certain banking circles in Berlin which have not seen this memorandum but which know of it and its contents in general terms, it is believed that Dr. Schacht couched it in his sometimes very caustic and sharp language, hoping that as a consequence Mr. Hitler would relieve him of his position in the Reichsbank. That the memorandum was presented by Dr. Schacht to Mr. Hitler and that the two points mentioned above were in it, I believe may be accepted as definite; but whether Dr. Schacht hoped to have it lift him out of the Reichsbank is of course only a conjecture which, however, judging from my own knowledge, I think cannot be altogether disregarded and which may have a good deal of justification. As I have already I think, told you, one of Dr. Schacht's really fundamental mental qualities is his extraordinary pride and confidence in himself and his jealousy of his position which he believes to be that of the world's great banker. He does not want to be associated with a failure. In spite of his confidence in himself and in his persuasive powers and in spite of the poor opinion which he has of American bankers and business men, I think he realizes so thoroughly the impossibility of controlling the radical elements in the present Government under the present form of the German regime, that he understands that no one is really in a position to make agreements with this present German Government. By his own cynical attitude towards Germany's obligations he has undermined what prestige he may have had abroad.

In view of Dr. Schacht's proposals which the Department is probably considering at this time, I think it is necessary for us not to neglect or to at
any time forget the real personality of the man. When he made his speech before the American Chamber of Commerce some weeks ago here in Berlin, with which speech you are fully familiar, he really opened there the back of his mind. He was in a belligerent attitude and he wanted to take the opportunity to tell us that Germany's debts to us were political and had to be wiped off the slate. He is so easily flattered himself, that he was sufficiently naive to believe that by making certain statements concerning President Roosevelt he could influence the President's attitude towards negotiations with Germany. You will probably be interested to know that the Americans here - and there were some 150 at least among those who heard Dr. Schacht that evening - are practically a unit in their confidence in, and their admiration of, the President, and Dr. Schacht's clumsiness in his reference to the President was, I think, genuinely resented by them all. He has been busy explaining ever since he made this speech, that he did not mean what he said concerning the "political character" of the private foreign debt of Germany; but any one who heard him as I did, knows what he had in mind and that what he said indicates his fundamentally cynical attitude; and in this respect he is no different from the secondary leaders of the National Socialist movement with whom he is so much in conflict. They are alike in their cynical disregard of contracts and of anything which involves the rights of other countries and of non-Germans.

I cannot escape the definite impression that the situation is developing rapidly in Germany towards a crisis and that economic factors which are stronger than any Government or Party and even stronger than the most well organized and disciplined praetorian guard are at work. It may be stated very simply and briefly as follows. The rearmament and general "Arbeitsbeschaffung" program of Germany under the new regime which has got under way in the last months, has created a need for more raw materials, many of which must come from the outside. Germany's exports have been steadily falling and are continuing to fall, with no ameliorating factors in sight. The allowances of foreign exchange to importers generally have
have been cut drastically again, so that the importations of non-essentials into Germany have already been tremendously reduced and cannot be reduced much further except through complete import prohibitions. The importation of essential raw materials such as cotton, wool, hides and copper, has already been placed under a Government-controlled monopoly which also controls the distribution of these raw materials to the factory. Further additions to this list are inevitable and in spite of the Government's disinclination to do so, oil may be the next article. The exchange position in view of these needs for raw materials and at the same time decreasing exports and an already unfavorable trade balance with the Reichsbank's reserves practically gone, is serious and in the course of some months will be "in extremis". There are of course certain stocks of raw materials on hand, so that production may continue at present levels in many lines in the country for some months. But it is clearly evident that unless an adequate supply of raw materials is assured, production and consequently employment in Germany, will have to go down, for employment has already been spread so thinly and average income so reduced and the reserves of establishments so affected, that people will have to be laid off. This is the great economic factor with its political consequences with which the Government and the Party are inevitably faced and they know that this factor is stronger than its praetorian guard.

There are only two ways out which the Germans can see. The one is by negotiation of very favorable agreements with the major suppliers of raw materials, and the other through the getting of credits.

With respect to the first way out Germany has already concluded a considerable number of agreements with her neighbors; but these do not assure her of the major supplies of raw materials which she needs and do not open to her for her exports the major markets which she needs desperately. In fact, even in those countries with which she has made agreements, her export business is mostly falling off. You know how eager they are to negotiate with us and I have
have told you how optimistic they are. I think they still believe that we are so eager to find an outlet for our agricultural surplus and that agricultural interests can exert such a pressure on our Government, that an agreement very favorable to them would be made by us. There are, however, those in the Foreign Office and in the Ministry of Commerce here who realize that no matter what concessions we might make with regard to reduced tariff schedules, production costs in Germany are mounting because of the internal agricultural and general economic policy. They know that a good deal of the advantage of reduced tariff rates would be lost through increased production costs in Germany. They know too that we have no "Zwangswirtschaft" in the United States and cannot compel importers or consumers to buy German goods and would not think of doing so and that there is a real disinclination in the United States to buy German goods, based on a general lack of sympathy towards the present German Government; and that this buyers' strike may be very effective as long as certain discriminatory measures remain in effect in Germany. They know too that even though tariff rates are reduced and that price factors might eventually develop a better market for German goods in the United States, the effects of such an agreement would be felt comparatively slowly and certainly not for months. The really well-informed here know that even though such an agreement is negotiated with all the extraordinary advantages for Germany which they could hope for, in practice the economic and political crisis here may have arrived before the agreement could have any alleviating effect on their situation. Of course there are many more people in Germany, especially the secondary leaders of the Party who hold the power, who do not realize the above factors at all and who simply feel that we will be forced to save our own situation in the United States by practically giving them our raw materials on any terms and they see this in terms of our taking as much in German manufactured goods as they buy from us in raw materials.

While I should welcome any arrangements really to our advantage which will open for us a market for
raw materials in Germany or keep open the market which we now have, I do not believe that we are in a position to make any long-range agreement with Germany at this time, and this first way out in the form of a trade agreement is, I believe, so far as we are concerned, a hopeless one for this present Government. At the risk of repeating I wish to say again that I do not think any agreement which we may make with the present Government means anything. I have given some of the reasons for this attitude in my despatches Nos. 1964 and 1970, but just as a further indication would like to tell you the following. 

There is no reason why a cigarette manufacturer in Germany should not buy all the Bulgarian tobacco he wants to. According to the trade treaty and existing regulations and decrees, a German cigarette manufacturer should be free to place an order at any time in any quantity in Bulgaria for cigarette tobacco. And yet a few days ago Mr. Kessler, the newly appointed "Reichsfuehrer der Wirtschaft", that is, leader of German business, who occupies a sort of semi-official position, informed all German cigarette manufacturers heretofore using Bulgarian tobacco that they could buy no more Bulgarian tobacco until "they had been able to make arrangements with Bulgaria to take certain German goods". In other words, in spite of a treaty and without any basis in law or decree, a semi-official person in Germany issues an order that purchases of tobacco should be stopped from Bulgaria until further notice; and no cigarette manufacturer in Germany would dare to disobey this order! This simply means that no matter what agreement Mr. Schacht has in mind about buying so much cotton a year from us at a certain price and no matter what solemn obligations might be entered into by the German Government that these purchases will be maintained at a certain level and price, the internal situation in Germany is such that at any time such an unofficial or semi-official person as Mr. Kessler can say to the cotton textile manufacturers that they shall stop using American cotton until a certain amount of Egyptian, Indian, or other cotton has been used up, as it has been possible
possible to make a very advantageous arrangement to take this cotton instead of the American in the meantime, for which they will be paying, let us say, in iron pipe or some other German product. I do not like to insist too much on this, but those who know the internal situation here realize that this is the sort of thing from which all business in Germany is suffering and that the Government is in no position to control it; and until there is a Government here which is really in control and which can maintain and which intends to maintain its international obligations, there is no use or sense in entering into an agreement. Anything else would be in its last analysis a fundamental betrayal of the interests of our own country, something which even the most radical and prejudiced and one-sided agricultural economist would not think of.

The second way out would be through credits and I rather think that the Government will place its main reliance in that. This is a matter concerning which I feel I should not write you because you have so much more information available and more background at home than we can possibly have here. Mr. Schacht's proposal of a raw material credit which the Embassy transmitted with its despatch No. 681, is so naive that I doubt whether the Department has been able to give it serious consideration. He talks so calmly of converting a nominal 850 million dollar obligation of Germany in the United States into a real one of some 500 millions, which our Government is to take over. Mr. Schacht obviously believes that it will be much easier for the Germans to get out of an obligation to our Government than out of an obligation to private bondholders. The proposition shows how simple and naive he thinks we are, and what little regard he has for our intelligence and banking ability. He lays all Germany's troubles and the failure in capacity to pay interest to bondholders, to the "dictate of Versailles"; but he leaves out of account the fact that it is the present National Socialist Government which during the past year has done the most to cripple Germany and to destroy her foreign trade which he himself emphasizes is her principal capacity to repay. He
wants a credit from us for the purpose of propping up a regime which is daily by its acts and by those of a Party which it is frankly proclaimed is the state, discriminating against American imports and American interests in Germany guaranteed by treaty and international practice. He wants a credit from us to help a regime which by its own acts is destroying its capacity to repay. He wants a credit for the purpose of maintaining a regime with the acts of which in many respects he is in no sense in sympathy and the dangers of those policies for Germany and for the quiet of the world he thoroughly understands.

These are the two ways out, and as few who understand the situation believe that relief can come through these channels, they believe the crisis seems inevitable and there is a growing impression that it is only a question of time before these economic and financial factors will bring about a fundamental change in the German regime. The next steps will probably be the creation of further import monopolies over raw materials. It is quite likely that there will be complete prohibition of the importations of certain manufactured goods which are still coming in in spite of the exchange restrictions and the decreased exchange available for them. Stoppages of payment of interest and amortization charges on the foreign debt except in marks or scrip, is practically a certainty. The rationing of raw materials to industry, already begun, will most likely be extended over a wider field and be followed by the actual rationing of certain finished goods to the consumer. In informed circles the return to a practically wartime regime of rationing industry and the consumer, seems certain. Whether the disillusionment and the distress can be borne by the German people, is a question which the best informed persons I have been able to talk with believe is one of time. I have talked with many patriotic Germans who for the first time see a ray of hope, for they feel that the situation has developed within the last three months more rapidly than they thought it could develop in about eighteen months. They feel that the greatest hope that they can have is that the rest of the world will maintain its present attitude, refusing to prop up
up in any way the existing regime, opening the possibility for the German people to really get their Government into their own hands and to establish a system which can live at peace with its neighbors and maintain the possibility of a reasonable economic and social standard in the country. These people feel that the Party by its acts, is destroying itself and its hold on the country and unless propped up from the outside, the way will be open for reasonable elements to secure control. These do not fear a more radical or communistic regime. I do not wish to make any prophecy of my own, but my belief is that the sound sense of the mass of the German people is returning very rapidly and that any change is likely to be in the direction of a reasonable Government with which the ordinary agreements between states can be entered into and the way opened to them for financial assistance and to those agreements of which undoubtedly Germany is in need. The new regime, by removing discriminatory practices within the country and by radical changes of policy from those of the existing Government, would in the opinion of many remove those antipathies which have isolated Germany politically and economically, and give new confidence in the country.

The Acting Commercial Attache, Miller, who is a very well-informed person and a very useful man in our Government family here, is preparing a memorandum preparatory to the expected arrival of Mr. Child here, and as soon as it is completed I will see that a copy is forwarded to you. I know the ground which he intends to cover and I am sure that it will be a document of very real interest to the Department.

I have inflicted a very long letter on you, but I felt that these considerations would be of interest to you.

Cordially and faithfully yours,

The Honorable
William Phillips,
Under Secretary of State,
Washington, D.C.