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# Formation of U.S. State Department Economic Foreign Policy for the Occupation of Postwar Germany, 1939-1948

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FORMATION OF U.S. STATE DEPARTMENT ECONOMIC FOREIGN  
POLICY FOR THE OCCUPATION OF POSTWAR GERMANY,  
1939-1948

by  
Rick Jeffers

A Thesis Submitted in  
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ABSTRACT  
FORMATION OF U.S. STATE DEPARTMENT ECONOMIC FOREIGN  
POLICY FOR THE OCCUPATION OF POSTWAR GERMANY,  
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by

Rick Jeffers

The University of Wisconsin-Milwaukee, 2015  
Under the Supervision of Professor Winson Chu

This study examines how a firm belief in the economic doctrine of multilateralism triggered a powerful policy-determining crusade within the U.S. State Department. This doctrine was fundamental to the establishment of postwar foreign policy toward Germany. It was present in 1939 during early planning meetings and lasted through to the 1948 division of Germany. The equitable application of multilateralism as a basis for foreign policy determination was not initially accepted by other sectors of the U.S. Government; but over the course of this period State Department officials were able to overcome intergovernmental resistance. Motives for postwar planning for Germany were based on concerns over the growth of economic nationalism, which had led to a dramatic decrease in international commerce during the 1930s. This paper follows the web of multilateral foreign policy implementation as it weaves its way through the early planning process, interdepartmental disagreements, severe problems during the military occupation, and finally an impasse with the Soviets over occupied Germany.

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This work is dedicated to  
My wife Geri  
And sons  
Scott and Matthew

I would like to thank my major advising Professor Winson Chu, along with Professor Aims McGuinness, and Professor Christine Evans for their guidance and support. I would also like to thank my wife Geri for her patience and help proofreading. I would like to acknowledge Scott Jeffers, Mathew Jeffers, and Mary Sigrist for their assistance with reading and editing, and Julie G. for her assistance in proofreading. I would also like to express my gratitude to Peter B. and Jonathan B. from the UWM Writing Center for their contribution to this project.

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## LIST OF ABBREVIATIONS

ACC	Allied Control Council
ACFPF	Advisory Committee on Postwar Foreign Policies
CEEC	Committee of European Economic Co-operation
CFM	Conference of Foreign Ministers
CFR	Council of Foreign Relations
EAC	European Advisory Commission
ERP	European Recovery Program
FRUS	Foreign Relations of the United States Collection
GATT	General Agreements on Tariffs and Trade
IAR	International Authority for the Ruhr
ITO	International Trade Organization
SHAEF	Supreme Headquarters Allied Expeditionary Force

## Introduction

At the dawn of the twentieth century, Germany stood at the hub of a delicate commercial trade network that covered much of the world. World War One and, even more so, the Great Depression had shaken that structure until the final calamity struck in 1939, leaving a world barren and defaced. The post-WWII effort to rebuild this multilateral trade network was spearheaded by the US State Department. Their effort was unique; it called for a concerted large-scale effort by a victorious United States to partner with its wartime allies and drastically expand the international trading system with the intent of creating prosperity for all. Even the defeated nations were to be included. In the past, military victories were usually followed by empire, imperialism, colonization, Balkanization, or retribution. US State Department officials planned for a different future; they believed that the reconstruction of the victorious nations could not be separated from reconstruction of their wartime enemies. National borders would be unable to restrain postwar reconstruction, and Germany and Japan would need to play a pivotal role in a world system of multilateral trade.

The peace and prosperity of the second half of the twentieth century were at stake, and the United States had no choice but to take a leading role. The 1945 to 1949 occupation period was a difficult one, but by 1950, West Germany and Western Europe were well on the way to full economic recovery. The constructive achievement of this accomplishment had its foundation in the 1930s with a group of individuals centered at the US State Department, under the direction of Secretary of State Cordell Hull and his chief economist, Dr. Leo Pasvolsky. They pursued an unyielding effort to use the power

of the US economy to construct a capitalist world economic system based on multilateral cooperation rather than economic nationalism. This paper demonstrates how by 1940 a resolute foreign policy consensus had developed at the US State Department and how officials sought to create a multilateral, free-market, free-trade scheme on an international stage. It was anticipated that this policy would eliminate the possibility of a reoccurring depression and foster prosperity for the United States and others during the postwar period.

US occupation policy toward Germany was complex and unique. State Department officials who formulated policy for the German postwar period had to struggle with interdepartmental disagreements, make changes to resolve difficult circumstances in Europe, and react to perceptions of Soviet expansionism. However, from 1939–1949, this multilateral economic outlook was the keystone of US foreign policy. During negotiations for the occupation of Germany, this policy was pursued aggressively by State Department officials and eventually overcame challenging policy schemes from the Treasury, War, and Executive branches. State Department multilateral economic policy had far-reaching effects on the German occupation and was consistent with the long-term US State Department goal of creating a multilateral world of free–markets and free–trade.

The policy originating in 1939 by the early postwar planners at the US State Department rested on the principle of multilateral economic cooperation among nations. It was a single thread that led through a tangled web of US global strategy stretching from 1939 to 1948. Their concept was based on multilateral trade; that is, trade between groups of nations whose exports and imports are not in balance between two nations but

whose balance of payments will likely find equilibrium in regard to trade with all nations. This trade usually conforms to comparative advantages in which countries attempt to buy imports at the cheapest price and sell exports at a premium price.<sup>1</sup> Over the course of the 1939 to 1948 period, this multilateral concept became second nature among State Department officials, and eventually, the consensus of the US government and military establishment.<sup>2</sup> By 1948, because of its powerful economic position, the United States had the ability to set many of the rules for the postwar international commercial system. Being in the position of an occupier of Germany, the United States was able to use the potentially strong German industrial economy as leverage in Europe, around which multilateral connections could be based.

Large financial interests in the United States started to recognize the importance of European-US economic interaction soon after WWI. Prosperity during the 1920s coincided with a redevelopment of US exports to Europe. Instability in Europe in the 1930s coincided with the depression and a dramatic reduction in international commerce. The Dawes plan of 1924 was at its heart a concerted effort by a group of private US investors lead by the Morgan Guaranty Trust Company to make capital available to Europe through loans to Germany, with the intention of invigorating international commerce.<sup>3</sup> During the interwar period, leading capitalists on both sides of the Atlantic were troubled by each other's actions. The development of National Socialism in Germany during the 1930s presented itself to financial elites in the United States as

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<sup>1</sup> David W. Pearce, ed., *The MIT Dictionary of Modern Economics: 4th Edition*, fourth edition edition (Cambridge, Mass: The MIT Press, 1992), 292.

<sup>2</sup> Bruce Kuklick, *American Policy and the Division of Germany; the Clash with Russia over Reparations*. (Ithaca NY: Cornell University Press 1972, 1972), 227.

<sup>3</sup> Maurizio Vaudagna, *The Role of the United States in the Reconstruction of Italy and West Germany, 1943-1949: Papers Presented at a German-Italian Colloquium Held at the John F. Kennedy-Institut Für Nordamerikastudien, Berlin, June 1980*, 8.

autarchic and ruthless. They believed that Nazism could not exist without a German industrial elite whose actions stoked the fires of fervent economic nationalism; this was a threat to the expansion of American free enterprise.<sup>4</sup> The German Nazi party saw the United States, not the Soviets, as their chief long-term economic antagonist. They had little respect for the Soviets or the British as a world force and saw the eventual confrontation in terms of a German nationalist economy coming in opposition to a US-lead world economy.<sup>5</sup> The outbreak of war in 1939 preempted an international economic showdown between the German and US versions of international commerce. The ability of the US industrial economy to produce an unlimited volume of armaments to supply its WWII allies suggests that Hitler may have realized that he had better odds by striking quickly with his military on the European continent, rather than risking the eventuality of a long-term economic showdown with the United States on a worldwide stage.

### Historiography

The historiography addressing postwar economic policy planning follows a multiple series of debates, the most prominent of which concerns the role of the United States in the economic recovery of Europe. When historians who write about this period are defined as traditional or revisionist, it often refers to their position on the contribution of the United States to the economic recovery of Europe. A traditional historian would assign a great deal of credit to the United States for European economic recovery. A revisionist would assign only a minimal benefit to the United States. This would also hold true for the recovery of Germany. A traditionalist would assign a great deal of value

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<sup>4</sup> Ibid., 39.

<sup>5</sup> Ibid., 69.

to the US occupation policy. For example, substantial credit would be given to the United States for limiting reparation payments from Germany, enacting currency reform, and integrating Germany into the European Recovery Program (ERP). There are a number of revisionists who give the United States modest credit for European recovery but, as a direct result of the occupation, give the United States considerable credit for West German recovery.

A second major historiographical debate centers on the division of Germany into East and West. A traditional view would place the blame predominately on the Soviets; a revisionist would place a significant amount of blame on the United States. Other historical debates can be recognized. There is a difference of opinion as to whether US policy toward occupied Germany was driven by economic or political goals. There is also a debate as to whether or not the problems encountered in the immediate aftermath of the war were due to a US State Department preoccupation with long-term planning while overlooking the need for short-term planning.

One of the best early accounts of US policy is *Economic Planning for the Peace*, written by E.F. Penrose in 1953. This study focuses on the 1940 to 1947 period, but Penrose does address US policy developments in the early 1950s. Penrose wrote his account as an insider; he worked with Dr. Isaiah Bowman on postwar planning until 1941 when he was appointed economic advisor to John Gilbert Winant, the US Ambassador to the United Kingdom.<sup>6</sup> Penrose is considered a traditionalist as he points to the ERP as being the boldest, most imaginative, and successful international policy measure ever taken by the United States. He described the conditions in Europe in 1947 as a crisis; this determination is a key factor in differentiating a traditionalist from a revisionist. Most

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<sup>6</sup> E. F. Penrose, *Economic Planning for the Peace* (Princeton: Princeton University Press, 1953), 8.

historians who wrote close to this period never questioned their assertion that 1947 was a year of crisis in Germany and Europe. By the 1980s, with the release of financial documentation from the period, revisionist historians who studied empirical data from the postwar period assert that 1947 was not a year of crisis. These historians point to economic data that shows a consistent recovery starting as early as 1945. To Penrose and other traditional historians, 1947 was undoubtedly a year of crisis; therefore, the recovery post-1947 constituted a dramatic improvement.<sup>7</sup>

In his 1984 book, *The Reconstruction of Western Europe 1945–51*, Allen S. Milward, a professor at the European University Institute in Florence, bases his argument on the conviction that 1947 was not a year of crisis. He acknowledges there were difficulties in 1947 but that they were just the result of economic growing pains. Milward, a leading revisionist, asserts that economic growth was well under way by 1947 and that the ERP had no overall dramatic effect on European recovery. For Milward, the difficulties of 1947 arose because economic growth was too fast. European nations were suffering from a poor balance of payments, namely a dollar gap. This condition was caused by a Bretton Woods agreement that was not comprehensive enough to handle the postwar financial needs of Europe.<sup>8</sup> Milward makes use of numerous charts, showing how nation-by-nation the upward growth curve of production was continuous from 1945 on. This was true for every nation except Germany, whose recovery was taking place at a much slower pace. Milward identifies the German recovery as being different than others in Europe and lists the absence of Germany trade from the European economy as one of

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<sup>7</sup> Ibid., 352.

<sup>8</sup> Alan S. Milward, *The Reconstruction of Western Europe, 1945-51* (Berkeley: University of California Press, 1984), 465.

the difficulties in 1947.<sup>9</sup> Possibly the best response to Milward's claim was made by William Diebold Jr. in his 1988 article "The Marshall Plan in Retrospect." Diebold, a Director of Economic Studies at the Council of Foreign Relations (CFR), points out that Milward's assertion—that 1947 was not a crisis—is not credible because it goes against what everyone in Europe thought at the time.<sup>10</sup> Perhaps the most abundant source for a traditional narrative that 1947 was a year of crisis comes directly from US State Department documentation. This primary source material continuously refers to 1947 as a year of crisis, and views the post-1947 recovery as dramatic.

A third version of historical events can be seen in John H. Backer's 1978 book, *The Decision to Divide Germany*. Backer served under General Clay in the economics section of the occupational government and went on to become Clay's biographer. Backer sees himself as neither a traditionalist nor a revisionist. He claims there was no grand design pursued by the US State Department, nor did he see any evidence of a long range Soviet design for conquest. He suggests that the Soviets were exhausted, close to starvation, and in great need of assistance. For Backer, US foreign policy was decisive in Germany, but not in the form of a grand design. He saw policy development as incremental, small steps developed in real time to deal with the immediate situation at hand. He gives a detailed account of more than fifteen decisions, starting with the weakening of the Allied Control Council (ACC) in 1945 to the currency reform of 1948, all leading eventually to the division of Germany.<sup>11</sup> This version directly challenges an earlier book written by Bruce Kuklick in 1972 titled *American Policy and the Division of*

<sup>9</sup> William Diebold Jr., "The Marshall Plan in Retrospect: A Review of Recent Scholarship," *Journal of International Affairs* 41, no. 2 (Summer 1988): 430.

<sup>10</sup> *Ibid.*, 431.

<sup>11</sup> John H Backer, *The Decision to Divide Germany: American Foreign Policy in Transition* (Durham, N.C.: Duke University Press, 1978), 173.



*Germany*. A professor at the University of Pennsylvania, Kuklick espoused a thesis similar to the argument that I make in this paper, namely that there was a multilateral consensus—a grand design—that was economic in nature and became second nature to diplomats at the State Department. Kuklick asserts that the American commitment to multilateralism demanded free markets and an aggressive economic stance. This ideology became central to US policy in occupied Germany and was directly responsible for the development of US-Soviet antagonisms. The United States was unwilling to concede to reparations and other economic issues because of its commitment to multilateralism, and it was this firm stance that led to the division of Germany and, ultimately, the Cold War.<sup>12</sup>

Another significant contribution to this study was *The West German Economy 1945–1955* written in 1991 by Alan Kramer, a professor of European History at Trinity College in Dublin. Kramer discounts the value of the ERP for the economic revival of Germany. His main argument is that Germany was poised to expand rapidly as soon as world trade revived. Allied bombing did not shatter the West German industrial economy. Economic recovery began in 1945 and developed as part of a European trade bloc, not an American style multilateral world system.<sup>13</sup> This is a similar position to what was taken by Milward; the resumption of trade for Germany came about as a result of a German-French connection combining to form an interdependent European system. German reentry into the West European economy had to wait until it became acceptable to the Europeans and was not the result of US foreign policy.<sup>14</sup> Kramer and Milward both maintain that the difficulty the United States had in reaching a mutual agreement with

<sup>12</sup> Kuklick, *American Policy and the Division of Germany; the Clash with Russia over Reparations.*, 6.

<sup>13</sup> Alan Kramer, *West German Economy, 1945-1955*, First Edition (Oxford: Berg Publishers, 1991), 226.

<sup>14</sup> Milward, *The Reconstruction of Western Europe, 1945-51*, 491.

European nations on ERP policy revealed how far apart the economic objectives of the separate nations were and that the redevelopment of European postwar trade favored the nationalistic interest of each separate nation, not an integrated mutual benefit to the group. Revisionist historians do give the ERP some credit for helping West Germany return to the European market. Postwar West Germany, unlike other ERP participants, was in no position to object to interference by the United States in its national sovereignty, and at the time, was in critical need of US funding for import materials. Both Milward and Kramer acknowledge that the ERP had a positive effect on the return of commercial trade to Germany, and because of its weakened condition it was more than willing to receive aid.<sup>15</sup>

The debate over the effects of short-term policy versus long-policy on the restoration of the German economy has been the cause of another rift amongst historians. Penrose blames the problems faced in Germany from 1945 to 1947 on the failure by the United States to develop an effective short-term policy. Preparation of long-term policy by the US State Department was well conceived and would have prevented the economic disaster of the interwar period in a reconstructed world. Penrose maintains that because Germany was in such a weak position in 1945, the long-term multilateral free trade policy pursuit of the US State Department was unrealistic. The economic errors of postwar planning were the omissions of preparation for short-term emergencies that arose in the immediate aftermath of the war. Penrose puts most of the blame for this omission on the interference of the Treasury Department in 1944.<sup>16</sup> This position is similar to the position held by Backer, and would seem to hold a significant amount of weight as both

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<sup>15</sup> Ibid., 471.

<sup>16</sup> Penrose, *Economic Planning for the Peace*, 360.

Penrose and Backer were in Europe at the time working on this problem. Penrose did see a value in the long-term planning done by the State Department, whereas Backer believed that the most important policy decisions were made at lower levels and prompted by immediate necessity. Backer saw little value in the long-term planning made by the US State Department for the German recovery.<sup>17</sup>

The main argument of this thesis is that the motivation behind State Department policy towards Germany was primarily economic with political motivations becoming secondary. Kuklick says something very similar. He frames the US commitment to economic multilateralism in an ideology that would serve the interests of the United States and all other nations. Multilateralism developed around a consensus that a country's economic institutions determine both its political institutions and the psychology of its citizens.<sup>18</sup> This stands in contrast to how Milward describes the motivation behind State Department policy. Milward states that US policy was formulated primarily for political objectives and only used economic policy as a mechanism.<sup>19</sup> Milward saw the aim of the ERP to create a political institution, the United States of Europe. It seems to me that Kuklick's argument is closer to the truth. Milward bases his ideas about US motivations on empirical data from European sources and comes to a conclusion about US State Department motives that is not substantiated by State Department documentation. Officials at the State Department talked to a certain extent about a politically integrated United Europe, but the overwhelming evidence from US State Department documents seems to point to a US foreign policy consensus that

<sup>17</sup> Backer, *The Decision to Divide Germany*, IX.

<sup>18</sup> Kuklick, *American Policy and the Division of Germany; the Clash with Russia over Reparations.*, 3.

<sup>19</sup> Milward, *The Reconstruction of Western Europe, 1945-51*, 5.

was determined to rebuild a European commercial system by using economic policy to create economic results with political benefits coming as a byproduct.

Historians like Bruce Kuklick, by advancing a theory that events like the division of Germany and the start of the Cold War were caused by a US foreign policy based on a firm belief in multilateralism, are considered part of a more extreme branch of the revisionist school.<sup>20</sup> It essentially suggests that Western economic theory favors multilateralism and that US State Departments motivations were driven by a belief that a worldwide system of trade would benefit everyone involved. Evidence of this can be seen in the willingness of early postwar planners to include everyone, including the Soviets, in its commercial trade plans. It was not until 1947 when the Soviets rejected multilateralism that political divisions were established. I do not completely agree with Kuklick, who seems to think that multilateralism was universally accepted by all US government agencies from the start. Kuklick maintains that Secretary of the Treasury Henry Morgenthau Jr., by promoting the Morgenthau Plan for the harsh treatment of Germany, was advancing a multilateral policy. Morgenthau believed that depressing the German economy would enhance British foreign trade. This may have been what Morgenthau believed, but it is not multilateralism. This thesis argues that the Treasury Department did not promote multilateralism. Their attempt to promote harsh treatment for Germany and advance an inadequate Bretton Woods Agreement were weak attempts to repair the conditions of the interwar period, not drive the postwar world toward an expanded prosperity. Kuklick seems to apply multilateralism broadly to all US government departments. This thesis presents a distinction, multilateralism was a policy first developed at the State Department that had to overcome opposition from the

<sup>20</sup> Backer, *The Decision to Divide Germany*, 174.

Treasury Departments and other branches of the US government before it later became accepted as a consensus by most US government agencies.

### Primary Sources

The primary documentation for this paper comes from the Foreign Relations of the United States Collection (FRUS), published by the US State Department. The original State Department documentation has been digitized and is available at the University of Wisconsin Digital Collections center. It consists of official documentation of all major foreign policy decisions that have been declassified for publication. The FRUS collection begins in 1861 with the Lincoln administration and runs through 1960. Produced by the US State Department Office of the Historian, it includes documents from various Presidential libraries, internal memoranda, documents from the State and War (Defense) Departments, and private papers from those involved in the creation of foreign policy. The framework for this paper was built around FRUS documentation from 1939 to 1948 relevant to the development and implementation of postwar economic policy toward Germany. Also included as primary source materials were speeches and publications from US government economists and diplomatic officials involved in the creation of policy toward postwar Germany. Finally, official publications from the Council of Foreign Relations and its members from 1939–1942 were included as essential parts of the first half of this paper. Throughout the ten years covered by this paper, there was a substantial turnover of department officials whose input affected policy decisions. For example, starting in 1939, Secretary of State Cordell Hull and his staff were at the center of policy development; Hull was then succeeded by Edward Stettinius Jr., James F. Burns, and George C. Marshall, respectively. In general, the group of State Department

officials in charge of policy in 1948 was a completely different group than those who started the process in 1939.

### Chapter Summaries and Related Secondary Sources

Chapter I, 1939: *An Assessment of Risk and Opportunity*, offers an assessment of the world economic situation as WWII approaches. Discussion focuses on the breakdown of the international trade by the introduction of trade restrictions and the growth of economic nationalism. Prewar economic warfare on the European continent is discussed as an unavoidable reaction by totalitarian leaders to US trade policy, including Hitler's seemingly sensible economic approach to rebuild German international commerce. US documentation shows concerns about the development of Germany's postwar plan for "New Order" in a Nazi dominated Europe, a nationalist system of international commerce at odds with US commercial interest. Authors like Vera Micheles Dean and Paul Enzig add to the narrative about the development of German economic nationalism. Starting in 1939, early postwar planners at the US State Department studied how the United States would have to react to the economic challenges of a European economy controlled from Berlin. As the military situation on the European continent changed, the US State Department had to also change policy formation and consider the implications and opportunities of an Allied victory. The State Department turned to a group of advisors who developed a unique plan based on a set of core economic principles designed to reassemble international trade to eliminate the possibility of a reoccurring depression.

Chapter II, 1939–1944: *Early Postwar Planning*, describes how two agencies—one governmental, the Advisory Committee on Postwar Foreign Policies, and one private,

the Council on Foreign Relations (CFR)—linked together to formulate postwar policy. They agreed on a strategy and a purpose that was driven by economic prosperity for all, including the defeated Germans. Three State Department policy papers are examined in detail: Percy W. Bidwell authors a proposal for postwar German commercial policy, Arthur Gayer and Alvin Hansen author a proposal for industrial cartels, and Diebold offers a proposal for postwar reparations. Although a general consensus was reached, the committee members were not in complete agreement. Isaiah Bowman and Sumner Welles, two influential committee members, came close to splitting the committee over proposals concerning the postwar division of Germany. Starting in August of 1944 the policy recommendations advanced by the postwar planners at the State Department was beginning to run into substantial resistance from officials at the US Treasury Department.

Chapter III, 1944–1945: Interdepartmental Struggle, covers intervention by the Treasury Department and the Executive Branch in State Department planning. 1944 was the start of a five-year campaign by the State Department to implement its multilateral free trade policy as the dominant feature of postwar Germany economic framework. This chapter looks at the development of a rivalry between State and Treasury over the general direction of postwar global commercial policy and examines how this would affect Germany. Harry Dexter White, a senior official at the Treasury Department recommended a twofold postwar policy agenda, a punitive approach to postwar Germany, and a commercial policy that was aimed at fixing the problems of the interwar commercial trading system. Meanwhile, Dr. Leo Pasvolsky and his colleagues at the State Department developed a more dynamic proposal to infuse the postwar world with an expansive prosperity that was to include Germany. The end result was a policy victory

for the Treasury Department, putting the State Department at a severe disadvantage at the start of the occupation. After losing this interdepartmental struggle, the effort to implement the vision of early postwar planners would be passed to a new group of State Department officials who kept the dreams of a prosperous multilateral world alive.

Chapter IV, 1945–1948: The Occupation Period, covers the occupation period immediately after the war and examines how policy evolved from a punitive JCS1067 directive issued in 1945 to a policy that by 1947 was promoting German prosperity. An important focus of this chapter is the misguided policy planning by all agencies of the US government in dealing with the realities of a postwar occupation. During this period, the State Department had to work closely with the occupation officials at the War Department, most notably, General Lucius Clay, head of US occupation forces. Clay's writings and military publications are examined, as they deal with a deteriorating situation.

Chapter V, 1947–1948: An Integrated West Germany, looks at how the commitment of the US State Department to a multilateral economy recovery affected the division of Germany and its return to prosperity. By 1947, the US State department was returning to a position of power in the development of occupation policy. The situation in Germany was becoming desperate and it appeared there was no good solution. There was little policy cooperation between the United States and the Soviets, and negotiations concerning economic and national unity issues were going nowhere. This chapter draws heavily on State Department documentation from the Policy Planning Staff (PPS) headed by George Kennan. The European Recovery Plan (ERP) developed under the direction of Kennan, became the State Department recipe for problems in Germany and Europe. After



it was unable to resolve the problem of German reunification with the Soviets, the US State Department turned to an aggressive economic policy, using ERP funding to set up a multilateral commercial system in the non-Soviet controlled portion of Europe.

## Chapter I

### 1939: An Assessment of Risk and Opportunity

#### The Growth of Economic Nationalism

The Great Depression of 1929 was a key turning point for the twentieth century. Economic insecurity during the interwar period was the result of escalating unemployment, increasing amounts of international debt, and insurmountable tariff barriers. The onset of the Great Depression not only reversed any positive aspects of the 1920s, but also severely compounded ominous trends that were developing in international commerce. As a result of this instability, significant counter forces took root at this time the revolutionary outlook of communism—a general contempt for the precepts of Christianity—and the failure of democracy to contend with economic distress. Loyalty and unity among nation-states were becoming progressively degraded.<sup>1</sup> The United States and other major powers routinely practiced nationalistic economic policies while international loans and increasing tariff barriers had suicidal effects on international commerce. Commercial trade among nations was drastically reduced to levels far below pre-WWI totals.<sup>2</sup> As this trend continued, nations increasingly turned to extreme nationalism.

<sup>1</sup> Harley A. Notter, United States, and Department of State., *Postwar Foreign Policy Preparation, 1939-1945*, Department of State Publication; 3580. General Foreign Policy Series; 15. (Washington, U.S. Govt. Print Off., 1949), 8.

<sup>2</sup> *Ibid.*, 9.

By 1933, the international system of trade and finance was crippled. Europe was in significant international debt and no positive steps were being taken to remedy the situation. Astronomical sums were being assessed on WWI reparation accounts. Even if a robust amount of international trade had existed, it still would have taken a massive effort to liquidate the magnitude of war debt and reparation payments that had accumulated. The situation was different for the United States than it was for Europe. As a creditor nation, the United States was able to provide large loans to foreign nations; this lending allowed the United States to maintain a high export level while restricting imports with the use of tariff barriers. Consequently, a significant portion of the United States lending to European nations was used to cover the debt owed.<sup>3</sup> The continued lending from the United States only served to further destabilize the international commercial system.

The interwar period was dominated by a steady growth of exaggerated protectionism. Because of the reduced volume of international commerce, debtor nations, like Germany, could not generate enough trade income from which to meet their obligations. Trade restrictive policies by creditor nations, like the United States, perpetuated this international imbalance.<sup>4</sup> The United States assumed the responsibility for starting the process in 1922 with the enactment of the Fordney-McCumber Tariff. By the mid-1920s, Europe, especially Germany, responded with its own protectionist tariffs. Then, in 1930, the United States compounded trade obstacles with the Hawley-Smoot Tariff.<sup>5</sup> Over the course of the interwar period, greater obstacles were being placed in the

<sup>3</sup> Leo Pasvolsky, *The Problem of Economic Peace after the War.*, [United States] Dept. of State. Publication,; 1720; Commercial Policy Series,; 72; (Washington, U.S. Govt. Print. Off., 1942), 10.

<sup>4</sup> Ibid.

<sup>5</sup> Ibid.

way of imports. As a consequence, the total volume of international commerce was in steep decline, much lower before WWII than it was before WWI.

International support for high tariff policies and poorly conceived international loans spread poverty and despair at a time when the world was looking to the United States leadership.<sup>6</sup> Nations practiced economic discrimination with complete disregard for others. Foreign trade was considered a cutthroat game open for each nation to profit by taking advantage of its neighbor. In the US, an isolationist sentiment had taken control over national policy. The US contribution to these “beggar-thy-neighbor” policies caused lower living standards in nations around the world. American private investors perpetuated the problem by making irresponsible loans to debtor nations. During the 1920s, the United States became the world’s largest creditor nation. Much of the money borrowed by nations was used to purchase US exports or to pay back loans owed to the US government. Loans made to Germany, in particular, were part of a circular scheme; borrowed money was being used by Germany to make reparation payments to US WWI allies who, in turn, would use the same money to make war debt repayments back to the United States. At the same time, these countries’ exports were being purged from the US market because of the US’ high tariff environment denying them much needed trade revenue.<sup>7</sup> The international trade barrier problem was further compounded in 1932 by the introduction of the Ottawa agreements. British Commonwealth nations, as a reaction to US tariff policy, set up a zone of imperial trade preferences amongst themselves. International trade with Canada, Australia, India, South America, and other British Commonwealth nations was severely limited because of heightened trade barriers

<sup>6</sup> Sumner Welles, *Post-War Commercial Policy*, Department of State. Publication ; No. 1660; Commercial Policy Series ; No. 71; (Washington: U.S. G.P.O., 1941), 3.

<sup>7</sup> Ibid.

established within the Commonwealth.<sup>8</sup> In an era of deteriorating international cooperation, extremist nationalist political solutions were gaining popularity. Nations, like Germany, for which economic prowess should have been able to provide a stable and prosperous standard of living for its citizens were mired in economic distress.

The growth of international commerce was also restrained during the interwar period by the expanded use of industrial cartels. Unlike in the United States where cartels were viewed with animosity, European nations increasingly developed cartel arrangements to gain control over targeted markets. The proliferation and popularity of industrial cartels was not limited to Germany. The division of world markets is always a critical element of any cartel agreement; the goal of an arrangement is to eliminate import competition and to inhibit the growth of domestic industries. For example, in February 1939, at a meeting in Düsseldorf, Germany, the Federation of British Industries arranged with the German Reichsgruppe Industrie to divide Latin American markets in a coordinated effort to drive out other exporters. Also, during the 1930s, IG Farben and other British industries united to create dumping zones in South America to drive out other importers and eliminate domestic competition.<sup>9</sup> European industrial cartel policy threatened US export industries and prevented the growth of domestic industries in Latin America. By the late 1930s, the tide of economic nationalism was overtaking any pragmatic approach to the liberalization of international commercial policy as European nations increasingly turned to cartel arrangements.

In this tragic era, the most significant effort to reverse the fatal protectionist trend was started in 1932 by the new US Secretary of State Cordell Hull. Secretary Hull, from

<sup>8</sup> Penrose, *Economic Planning for the Peace*, 21.

<sup>9</sup> Council on Foreign Relations, *Postwar Controls of the German Economy*, ed. Percy Wells Bidwell, American Interests in the War and the Peace (New York: Council on Foreign Relations, 1944), 11.

the beginning of his term, was an unwavering free trader. With the support of the Roosevelt administration, Secretary Hull actively sought to reduce US tariff barriers. His method involved bypassing the need for Senate ratification by making use of bilateral agreements with multiple nations.<sup>10</sup> With the implementation of reciprocal trade agreements negotiated by the executive branch, he started the process of reducing tariffs, quotas, and import restrictions. Basing US policy on the widest application of “most-favored-nation” status, he sought to eliminate discriminatory commercial trade policy.<sup>11</sup> Secretary Hull’s effort to expand international commerce was in jeopardy throughout the 1930s as other nations increasingly continued their move toward extreme protectionist economies.

#### German Policy and Economic War

By the late 1930s, international commerce had moved beyond beggar-thy-neighbor protectionism to a state of economic totalitarianism. The United States had to adapt to an international atmosphere that to a great extent had become outside of its reach. Terms, such as economic warfare, autarky, and economic totalitarianism, were being used to describe the policy pursuits of Germany and its allies. These designations communicated a hyper-aggressive form of commercial policy that became detrimental to human welfare.<sup>12</sup> The obstruction of international trade by excessive barriers served to fortify German prosperity into a self-defined zone. By rigid regimentation of the trade process, drastic selection of imports, and aggressive policies toward weaker countries, Germany made the substantially reduced volume of international commerce serve the

<sup>10</sup> Penrose, *Economic Planning for the Peace*, 22.

<sup>11</sup> Pasvolsky, *The Problem of Economic Peace after the War.*, 16.

<sup>12</sup> *Ibid.*, 4.

needs of its rearmament program.<sup>13</sup> The economic autarchy practiced by Germany at this time bred international conflict, animosity, and ill will.

Autarchy found its roots in the distinction between national economies and world economies. Various historians, commentators, and economists have sought to rationalize Germany's aggressive economic policies by claiming that the German system, based on autarchy, developed a distinctive set of characteristics of its own that differed from that of US and other Western capitalist systems. In his book *Hitler's "New Order" in Europe*, Paul Einzig contended that German commercial policy differed from other Western nations because the common notion of an international division of labor was never popular in Germany. Much of German economic thought developed as an antithesis to Adam Smith-type laissez-faire principles. For Germany, the concept of an international division of labor enabling a free and open international exchange conflicted with tendencies toward a German "national system."<sup>14</sup> In the nineteenth century, German economist Friedrich List developed an economic theory involving a national system that opposed absolute free trade, which meant that every country should produce at home all of the goods necessary for its national security. Since the closing decades of the nineteenth century, German statesmen had practiced List's doctrine; a number of economically unjustifiable industries were developed for purely military considerations.<sup>15</sup> Since the advent of the Nazi regime in 1933, the German national system of autarchy and economic warfare had been executed to an extreme.

<sup>13</sup> Leo Pasvolosky, *The United States in the World Economy, 1940 Some Aspects of Our Foreign Economic Policy*, Department of State. Publication,; No. 1595; Commercial Policy Series,; (Washington, U.S. Govt. Print. Off., 1941), 22.

<sup>14</sup> Paul Einzig, *Hitler's "New Order" in Europe*. (London, Macmillan, 1941), 102.

<sup>15</sup> *Ibid.*, 104.

Although Germany had achieved technical maturity, some question if it had achieved political and social maturity. In his book *The Struggle for World Order*, Micheles Dean argued that because the Germans, unlike the French and English, had failed to achieve national unity until relatively recently, they remained outside the mainstream of Western social and political development. In the 1930s, Germany had the outward appearance of a modern state with up-to-date industrial techniques, but it really belonged to a different formation than that of Western Europe. Politically, Germany was still living in the sixteenth century. Germany, because of its belated union, failed to share in the social and political developments that formed the Western European tradition.<sup>16</sup> Because of this lack of social and political development, Germany was unable properly integrate in the Western world economy.

Some historians identified certain groups like industrial leaders or the Junkers for the creation of German nationalist polices. In his article “Postwar Controls of the German Economy,” Percy W. Bidwell, a member of the Council on Foreign Relations, assigned a considerable amount of responsibility for Germany’s aggressive economic policy to the Junker class. Bidwell acknowledged that it would be an obvious overstatement to assign the Junker class sole responsibility for economic warfare; however, the Junkers, together with their industrial counterparts, were largely responsible for Germany’s high protective trade policy since 1879.<sup>17</sup>

The best way to clarify the motivations that drove European economic nationalism is to look at the statements made by the European heads of state. In February 1940, President Roosevelt sent Under Secretary of State Sumner Welles to Europe on a

<sup>16</sup> Vera Micheles Dean and Foreign Policy Association, *The Struggle for World Order*, Headline Books, no. 32 (New York: The Foreign Policy Association, 1941), 12.

<sup>17</sup> Council on Foreign Relations, *Postwar Controls of the German Economy*, 22.



fact-finding mission. Welles was assigned to meet with German, Italian, and other European leaders to ascertain if grounds for a peaceful settlement existed. Two important topics of discussion were that of international commercial policy and the Roosevelt administration's attempt to lower world trade barriers.

Statements made by Hitler, Ribbentrop, and Mussolini put into perspective the economic environment of the time. Benito Mussolini, Adolf Hitler, and German Foreign Minister Joachim von Ribbentrop made it clear in discussions with Welles that they blamed both the United States and Great Britain for starting a tariff war. As Mussolini expressed, there was no greater discrimination policy than what was found in the Ottawa Agreements or the tariff policy pursued by the United States before the start of the Roosevelt Administration. Mussolini further stated that Italy was the last major country to enter into an autarchic system and did so solely as a last resort. Italian policy was developed as a self-defense mechanism after being confronted by large trade obstructions established by the United States and Great Britain.<sup>18</sup> The Italian leader unmistakably described the United States as the first aggressor against the freedom of international commerce.

Welles's then visited Germany to meet with Hitler's inner circle to discuss international commerce, among other things. At this time, Nazi Germany was not overly concerned about the development of trade on a global scale, but it did aggressively pursue strict control over its European market. Hitler had a different perspective than Mussolini; he explained to Welles that unrestricted international trade was not the cure for the world's economic problems. Because of the industrial nature of both the US and

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<sup>18</sup> United States Department of State, "Foreign Relations of the United States Diplomatic Papers, 1940. General," 1940, 31, <http://digicoll.library.wisc.edu/cgi-bin/FRUS/FRUS>.

German productions, it would be better for Germany to intensify its trade relations with countries in Central and Southeastern Europe.<sup>19</sup> Hitler stipulated that Germany would benefit more from increased trade within the European continent because its immediate neighbors had a greater need for German industrial products than the United States. Welles countered Hitler's argument by pointing out that the standard of living was too low in Southeastern Europe to make German industrial trade profitable. Industrial trade between Germany and the United States would be more advantageous for both parties.<sup>20</sup> This argument did not impress German leadership; they believed that challenging the United States at this time on a global level would not have been productive. Consolidation of their position in Europe would be the best policy for Germany interests.

In a private conversation with Ribbentrop, Welles took the opportunity to outline the current US position on international commercial policy as developed by Secretary Hull. Welles explained that so long as Germany pursued its present autarchic policy and made use of every form of tariff discrimination, there would be no opportunity for the United States to improve relations with Germany.<sup>21</sup> The development of a sound liberal trade policy was the only way for the world to retreat from economic warfare and return to a state of economic recovery.<sup>22</sup>

By 1939, the military buildup had completely changed the nature of German commercial policy. Trade regimentation and narrow bilateralism was implemented not for economic reasons but for the purpose of rearmament. Market forces did not drive German import decisions. The purpose of Germany's highly selective trade process was

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<sup>19</sup> Ibid., 68.

<sup>20</sup> Ibid.

<sup>21</sup> Ibid., 40.

<sup>22</sup> Ibid., 118.

to maximize importation of the materials needed for armaments.<sup>23</sup> This policy would be unsustainable over a long period without some type of forceful action on Germany's part. As Germany's demands for resources from its European neighbors grew so did their resentment. To pay for the large amounts of imported raw material and equipment, Germany used a type of enforced credit designation—a system of blocked marks that represented enforced loans to Germany by the countries from which it made its purchases. As time passed, Germany began to encounter greater difficulties in the operation of its trading system. Its trading partners became increasingly resistant to German policy of enforced credit and the large amounts of commodities it required.<sup>24</sup> As more time passed, Germany needed to be even more forceful in its dealing with its neighbors.

As the 1930s were coming to an end, Germany's trade policy was drastically unstable. Germany had trouble reaching its desired trade levels, exporting only about half of what it had ten years earlier. In 1938, Germany's export level was only 59% of its 1929 level, whereas Great Britain's exports had reached 74% of its 1929 level, and the US reached 79% of its 1929 export level. Germany's international trade system was becoming unsustainable. The long-term result of this policy was the requirement of increasing the use of coercion with its trading neighbors to gain the resources it desired. Thanks to the Anschluss and Hitler's raiding of Austrian gold and foreign reserves in the Austrian National bank, Germany was able to get thru 1938 by ruining a 450 million Reichsmark trade defect.<sup>25</sup> This was only a temporary fix, as by 1939 Germany was back

<sup>23</sup> Pasvolsky, *The Problem of Economic Peace after the War.*, 13.

<sup>24</sup> Ibid.

<sup>25</sup> Adam Tooze, *The Wages of Destruction: The Making and Breaking of the Nazi Economy* / Adam Tooze. (London/ New York, Allen Lane, 2006), 246.

to running balance of payments deficits. This problem was highlighted by Hitler's announcement in 1938 that "Germany must either export or die."<sup>26</sup> As Dr. Leo Pasvolsky, Special Assistant to Secretary of State Hull, explained in his 1942 US State Department publication "The Problem of Economic Peace after the War," whether German leaders looked at their commercial policy in the 1930s as being permanent was debatable, but it was clear that Germany's trade policy had a powerful impact on the disruption of European trade relations.<sup>27</sup> It seemed that in 1939, war had arrived just in time to save Germany's economy from this critical trade imbalance.

In addition to an aggressive trade policy, Germany also promoted a strong international cartel arrangement that aggravated and prolonged international commercial relations. Industrial cartels caused dangerous security and political consequences by promoting the power of the German state. By controlling large portions of regional markets, German cartels raised prices at will, restricted output, and kept out newcomers.<sup>28</sup> German industrial cartels raised the price of coal, steel, and cement while the economy was experiencing a recession. For example, in 1929, the price levels in markets controlled by cartels was 94% of 1926 levels, while the price levels in markets free from cartels were 61% of the 1926 levels.<sup>29</sup> German cartels also over-reserved its share of critical products, like coal and steel, allowing Germany to become artificially self-sufficient.<sup>30</sup> The exclusive domination of German industrial cartels over markets contributed to poverty and increased economic tension in the region it controlled.

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<sup>26</sup> Ibid., 15.

<sup>27</sup> Ibid.

<sup>28</sup> Council on Foreign Relations, *Postwar Controls of the German Economy*, 7.

<sup>29</sup> Ibid., 3.

<sup>30</sup> Ibid., 7.

## The Economic Consequences of a German Victory

In the lead up to war, American policy planners were concerned that a German victory in Europe would have dire consequences for the future of US economic prosperity. Without an efficient and open international division of labor, there could be no hope of avoiding the financial ruin of the Great Depression. Economists from both sides of the developing conflict understood that to promote prosperity and to raise the standard of living for their citizens, nations had to look beyond their borders to expand trade. In considering the postwar possibilities, by 1939, US State Department officials realized that Germany was eager to undertake the reorganization of European trade on their terms.<sup>31</sup> The question in 1939 was whether the future process of organizing Europe into an efficient economic system would be done by the imposition of the German pattern or a more inclusive version sought by Western democratic powers.<sup>32</sup>

How commercial policy was to be arranged in the post-WWII period depended on the outcome of the war. Planners at the State Department considered whether a German victory would dictate a continuation of pre-war heavy trade restrictions. They questioned if Germany would retain its recent policy of aggressive self-sufficiency or eventually return to balanced economic relationships. Early overwhelming victories of the Wehrmacht in Western Europe required them to consider the consequences of a permanent system of economic autarchy across the European continent.<sup>33</sup> Most believed a German-controlled Europe would likely result in a highly-centralized trade scheme with Berlin as its focal point. In this case, the overall level of foreign commerce for the United

<sup>31</sup> Dean and Foreign Policy Association, *The Struggle for World Order*, 12.

<sup>32</sup> Ibid.

<sup>33</sup> Cordell Hull, *The Memoirs of Cordell Hull: 2 Volumes*, First Edition edition (New York: The MacMillan Company, 1948), 1629.

States would likely decline and the United States might eventually have to adopt German-type trading methods.<sup>34</sup> The State Department planners started to look at other regions around the world to fill in a perceived US trade gap.

Analysis done on the basis of a German victory showed that a future US economic trading bloc would be forcefully separated from European commerce. State Department analysts determined that a European Bloc controlled from Berlin would be more prosperous and self-sufficient than a US Bloc comprised solely of the Western Hemisphere. The United States without Europe would, at a minimum, have to integrate considerable sections of the British Empire or Asia to maintain prosperity.<sup>35</sup> The State Department was unable to take any regions for granted, even the British Commonwealth. As late as 1940, powerful elements in the British financial and industrial sectors believed that the domination of Europe by Nazi Germany and the existence of the British Commonwealth were not necessarily contradictory.<sup>36</sup> State Department planners were also particularly anxious about the possibility of German interference in the Western Hemisphere.

In 1940, the capitulation of the Netherlands and the French request for an armistice sparked US concerns about the possibility of German influence in Latin America, specifically that European countries with possessions in the Caribbean would have their territories transferred to Germany. The United States was also concerned that some Latin American countries would become politically dependent on Germany. In June 1940, the United States notified Germany through its diplomats in Rome and Berlin that

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<sup>34</sup> Pasvolsky, *The United States in the World Economy, 1940 Some Aspects of Our Foreign Economic Policy*, 25.

<sup>35</sup> Laurence H. Shoup, *Imperial Brain Trust: The Council on Foreign Relations and United States Foreign Policy* (New York: Authors Choice, 1977), 127.

<sup>36</sup> Sumner Welles, *The Time for Decision* (New York, London: Harper & Brothers, 1944), 76.

it would not accept the transfer of these territories to German control. State Department officials were disturbed by a threatening and contentious German response.<sup>37</sup> Although Germany made it clear that they would not be intimidated by US concerns, for the moment they were focused on Europe.

Hitler compared Germany's position in Europe to the US position in the Western Hemisphere. For the time being German economic interests would be best suited not by unrestricted international trade but by taking up trade with its Eastern and Southern neighbors.<sup>38</sup> As a great industrial power, Germany was entitled to safeguard its interest. Just as Latin America, quite legitimately, assured the position of the United States as a world power, Germany was also entitled to its sphere of influence and controlling position in Central Europe.<sup>39</sup>

A main economic objective of a victorious Germany in a postwar Europe was to gain control over the heavy industries of the nations it occupied, putting German monopolist's influence at the head of the European economy. With German management skill running the day-to-day operations, heavy industry would be the cornerstone of fascist occupation policy. The Krupp firm would run the European coal and iron industries under the direction of Herman Goring, the Flick firm under the direction of Heinrich Himmler would operate the steel industry, and the Schmitz firm under the direction of Joseph Goebbels would run the European chemical industry.<sup>40</sup> State

<sup>37</sup> Notter, United States, and Department of State., *Postwar Foreign Policy Preparation, 1939-1945.*, 1949, 32.

<sup>38</sup> State, "Foreign Relations of the United States Diplomatic Papers, 1940. General," 47.

<sup>39</sup> Welles, *The Time for Decision*, 95.

<sup>40</sup> Jürgen Kuczynski, *The Economics of Barbarism; Hitler's New Economic Order in Europe* (New York: International Publishers, 1942), 5.

Department planners understood that the implications of a German controlled European economy meant little opportunity for US interests.

American policymakers assumed that German postwar occupation economies would be guided by the following five principles: (1) to take over the heavy industries in occupied countries and put them under the control of German industrial cartels; (2) to eliminate domestic consumption manufacturing or any local industry that would compete with German firms; (3) to reorient new economies in occupied countries to predominantly agricultural production with a close tie to the German chemical fertilizer industry; (4) to develop the overall European financial policy to exclusively promote heavy industry and to cut financing to local consumer industrial manufactures; and (5) to limit the availability of capital, labor, and raw materials to local small businesses, shopkeepers, and independent craftsman.<sup>41</sup> Germany would dismantle most industries in conquered areas and transfer their work to the Reich, eventually creating a Germany as a super-industrialized workshop supported by an agriculturalized Europe.<sup>42</sup> Germany felt that it could sell this scheme to the European public as a new era of prosperity that would put an end to the deprivation of the 1930s.

As war started to rage across the continent both the United States and Germany began to develop plans for how Europe should be organized after the war. Both sides had their own visions for the postwar period. In 1940, Germany proclaimed a “New Order” for Europe by declaring that nations under German control would enjoy unprecedented prosperity and an increase in the standard of living. Berlin promised that once British resistance was overcome, there would be a new golden age for Europe. A reduction of

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<sup>41</sup> Ibid., 10.

<sup>42</sup> Einzig, *Hitler's "New Order" in Europe.*, 114.



personal freedoms in the occupied countries would be exchanged for a political and economic stability.<sup>43</sup> Nazi propaganda for the New Order promised the people of Europe a comprehensive plan for recovery and expansion. Centralized economic planning and finance would be extended over an entire German-controlled Europe. An expansionary monetary policy with all non-German currencies stabilized and set in relation to the Reichsmark, tied to a gold benchmark or to the dollar. Unemployment would cease to exist by use of a continental-wide division of labor. There would be an extensive rationalization on a continental scale under the direction of German cartels. Germany would maintain a stable price level for agricultural production in Europe by fixing commodity prices for long periods of time. All trade agreements would be negotiated between continents with Europe operating as a unitary trade bloc. Finally, Europe would internally become a free trade zone.<sup>44</sup> The specific plan envisioned by Germany fit the view of international commercial policy as explained by Hitler and Ribbentrop.

German economists had a different outlook on the international division of labor than that of US economists. A German run division of labor on the continent of Europe would be focused on German nationalist goals. Production would only be allowed if it would result in a higher return for German industrial interests.<sup>45</sup> Central planners in Berlin would pursue German interest over those of its vassal states. Although German propaganda claimed Europe would be a free trade zone, exports from occupied nations would only be allowed if they did not compete with German industry.<sup>46</sup> At times, vassal states would be required to over-export to third party nation simply for Germany to get a

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<sup>43</sup> Ibid., 2.

<sup>44</sup> Ibid., 43.

<sup>45</sup> Ibid., 106.

<sup>46</sup> Ibid., 23.

quantity of a particular foreign exchange currency of which it was short. An international division of labor did exist, but rather than operating for the needs of the market, it operated for the needs of a German military industrial structure.

In early 1940, the German plan for “international commerce” in the immediate aftermath of WWII was not yet completely agreed on by the Nazi leadership. But a main objective included a system set up under a regional organization. The world would be composed of continental economic systems divided by regions. British and American financial interests would be excluded from the European continent. Europe would be controlled by Germany, Africa split between German and Italian interests, and Asia controlled by Japan. Russia and the Western Hemisphere would be left alone at this time. The main objective was the creation of “Grossraumwirtschaft,” a European economy in which Western financial interests would be excluded, while the flow of production would be directed toward Germany.<sup>47</sup> This was drastically different than the multilateral system proposed by US planners in which the entire world would have equal access to markets and resources.

The June 1941 invasion of Russia by Germany started to change the outlook of US postwar planners about the prospect of a German victory. By 1942, State Department planners started to believe that a German defeat was inevitable. This initiated both a change in the direction and an intensification of planning. The long-term goal of a multilateral world now started to seem like a definite possibility.<sup>48</sup> A critical point of this strategic change was the concept of unconditional surrender. Early in 1943, a decision was made that would have major implications for postwar planning. Both Churchill and

<sup>47</sup> Dean and Foreign Policy Association, *The Struggle for World Order*, 67.

<sup>48</sup> Notter, United States, and Department of State., *Postwar Foreign Policy Preparation, 1939-1945.*, 1949, 52.

Roosevelt decided to accept nothing less than a policy of unconditional surrender.<sup>49</sup> For many Allied officials, the concept of postwar “economic security” became dependent on Germany’s total capitulation.<sup>50</sup> The German menace must be wiped out permanently before the world can take a new contractual form.<sup>51</sup> The Allied position seemed to solidify over the course of the war; it was anticipated that at war’s end Germany would not be in a position to refuse peace terms. The critical point was that there would be no bargaining and that postwar terms would be “imposed unilaterally” at the total discretion of the Allies.<sup>52</sup> For the State Department, this was seen as a golden opportunity for the United States to take on global responsibility at the end of WWII that it had refused to accept after WWI.

The Allied position of unconditional surrender was a goal that was targeted at the German leadership. At this early stage in the war, Roosevelt proclaimed that he felt no individual animosity toward the German and Italian people. However, he was intent on a complete change of their nationalistic systems. In August 1941, Welles quoted Roosevelt as stating that it was of great importance that a point of assurance must be given to the German and Italian peoples and that the British and the US governments desired to offer them fair and equal opportunity of economic character after the war.<sup>53</sup> It is not clear whether this was just public posturing in the midst of war or if Roosevelt changed his mind as the war dragged on. It seems that near the end of the war Roosevelt was saying

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<sup>49</sup> Penrose, *Economic Planning for the Peace*, 228.

<sup>50</sup> *Ibid.*, 217.

<sup>51</sup> State, “Foreign Relations of the United States Diplomatic Papers, 1940. General,” 5.

<sup>52</sup> Council on Foreign Relations, *Postwar Controls of the German Economy*, 2.

<sup>53</sup> United States Department of State, “Foreign Relations of the United States Diplomatic Papers, 1941. General, The Soviet Union,” 1941, 361, <http://digicoll.library.wisc.edu/cgi-bin/FRUS/FRUS>.

something different, by 1945 he favored a policy that would teach all the German people a lesson.

### What Was at Stake for the Postwar Period?

The US Department of State felt that the people of the United States and other nations must have a clear understanding of the stakes involved if the United States was to follow the techniques that would develop a strong economic peace in the postwar period.<sup>54</sup> Wars are not fought for their own sake, but for the sake of determining which of the protagonists will shape the peace that follows.<sup>55</sup> As for the United States, the world must be made aware that the United States is going to foster equality of economic opportunity for all nations. The cessation of armed hostilities will not be followed by a continuation of economic warfare on the basis of trade discrimination.

Postwar planners were aware that the world was watching how the United States treated Germany. Men and women everywhere were searching for a new order. Their real task was to define the democratic concept of the postwar order in such a way as to convince people throughout the world, including the defeated nations, that a victory by Western powers was their best chance for a period of economic prosperity and reinvigorated democracy. It would be disastrous for the world if Europe returned to an acute form of nationalism. US planners understood that at the end of the war that Britain would not command the world influence it did in 1939, that France could not recapture a position of European leadership, and that Russia could no longer be ostracized by the world. The central question was the role of Germany and the pervasive feeling of most in the State Department that the United States had the power to ensure that Germany would

<sup>54</sup> Pasvolsky, *The Problem of Economic Peace after the War.*, 22.

<sup>55</sup> *Ibid.*, 1.

be an equal member of a multilateral world and not be reduced to a second rate nation, even temporarily.<sup>56</sup>

State Department officials believed that comprehensive planning was necessary and that it must be done early. A delay in planning would allow special interest and pressure groups time to seek preferences for themselves and discrimination for others in the postwar economy.<sup>57</sup> The period following the war was as decisive as the war itself. Allies could not pursue the same misguided policies of the past by waiting for a postwar summit to set policy; the disastrous consequences of the post WWI era was to be avoided. The State Department was committed to the notion that economic prosperity was the key requirement for the establishment of an enduring peace. Postwar planners approached the reconstruction of the world's economy by taking into consideration the conditions that caused recent wars. Events of the previous decade led officials to devote their foremost attention to the relationship between foreign policy and economics. The coincidence of world depression with the rise of dictators appeared more than accidental. US State Department planners almost unanimously accepted the argument that economic distress was a major cause of WWII. Their direction of thinking was dominated by determining what measures could be undertaken to keep an economic depression from reoccurring.<sup>58</sup> As Secretary Hull proclaimed, "A world in economic chaos would be forever a breeding ground for trouble and war."<sup>59</sup> The State Department took this to heart and used this notion as a cornerstone from which to build policy.

<sup>56</sup> Dean and Foreign Policy Association, *The Struggle for World Order*, 22.

<sup>57</sup> Welles, *Post-War Commercial Policy*, 7.

<sup>58</sup> John Lewis Gaddis, *The United States and the Origins of the Cold War, 1941-1947*, Contemporary American History Series; (New York, Columbia University Press, 1972), 18.

<sup>59</sup> Hull, *The Memoirs of Cordell Hull*, n.d., 1681.

By 1941, economists at the US State Department held firm in their position that it was harmful to return to an international economic system based on small national units struggling with each other for currency, raw materials, and markets, while striving to cut each other out. They understood that the beggar-thy-neighbor policy of the 1930s hurt everyone. US planners looked to the end of hostilities for the formation of larger economic units calling for a greater measure of cooperation in trade in order to forgo a resurgence of worldwide depression. A change of direction was required, creating larger integrated markets and not a system of direct totalitarian interference in economic affairs.<sup>60</sup>

Planning for the postwar period became public on January 6, 1941 when President Roosevelt made his Four Freedoms speech. Even though classified planning had been underway at the State Department since 1939, it was this speech by Roosevelt that set the first public parameters for US postwar goals. President Roosevelt called for a world in which all people would share freedom of speech, freedom of worship, freedom from want, and freedom from fear. From this date, human freedoms, including economic security, were publicly proclaimed as a fundamental cornerstone of US postwar planning.<sup>61</sup> This speech significantly widened the basis for US foreign policy planning beyond what was previously discussed at State Department meetings.

#### A State Department Consensus on How to Plan

As WWII started in August 1939, Secretary Hull felt that all pre-1939 methods of preserving the peace were bankrupt; the United States had the ability and the burden to

<sup>60</sup> Dean and Foreign Policy Association, *The Struggle for World Order*, 82.

<sup>61</sup> Notter, United States, and Department of State., *Postwar Foreign Policy Preparation, 1939-1945.*, 1949, 42.

correct the mistakes of the past. The strength of the United States would put it into a position to refute its internal isolationist sentiment and begin to take responsibility for world leadership in the postwar period.<sup>62</sup> More than a responsibility, the current conflict presented itself to some US State Department officials as a grand opportunity for the United States to emerge as the premier power after the war. American interventionists at State were certain by 1939 that the conflict would involve the US and that prior preparation was vital not only for military preparedness but also for the broader terms of foreign policy.<sup>63</sup>

Planning postwar policy involved more than just governmental agencies. Quasi-governmental committees did much of the early planning. The Council on Foreign Relation (CFR) was the main non-governmental agency that worked to develop foreign policy and worked directly with the US State Department on many matters. The unofficial nature of the CFR was helpful to a Roosevelt administration that was reluctant, at this early stage, to publicly discuss its postwar planning objectives. A special type of institution like the CFR was critical to the validation of policy and to help develop a supportive public opinion. Despite a wide range of opinions and organizations actively commenting on policy at the time, the internationalist philosophy of the CFR best fit the views of the State Department. The CFR was helpful in developing the “correct” public opinion by direct contact between CFR sanctioned committees and the American public.<sup>64</sup> The necessity for governmental secrecy had to be balanced with the need to

<sup>62</sup> Hull, *The Memoirs of Cordell Hull*, n.d., 1625.

<sup>63</sup> Neil Smith, *American Empire: Roosevelt's Geographer and the Prelude to Globalization*, California Studies in Critical Human Geography ;; 9; (Berkeley: University of California Press, 2003), 325.

<sup>64</sup> Inderjeet Parmar, “: The Role of the Council on Foreign Relations,” *Studies in American Political Development* 13, no. 02 (1999): 342.

influence public opinion. Non-governmental agencies like the CFR were free to openly influence public opinion.

The group officials working at the State Department were strong internationalists, overwhelmingly in favor of free trade and easing commercial restrictions. This directly contradicted the reality of world governance up to this time. In general, during the first half of the nineteenth century, national economies had been moving away from laissez-faire capitalism and moving toward one form or another of collectivism. Whether it was, New Deal programs in the United States, or totalitarianism in Germany, a wide range of national and international economic controls was increasingly focused on national economic development and forsaking international commercial relations.<sup>65</sup> State Department officials were committed to change the situation by opening up international commerce in both the United States and abroad.

Planning for the postwar period started in 1939 and was centered at both the US State Department and the CFR. A group of planners assembled under the direction of Secretary Hull who agreed in principle on a basic set of common beliefs. These beliefs were to have a significant impact on US foreign policy from this date forward. The change from an isolationist to an internationalist attitude of the US government policy after WWII can be traced to the early ideas and recommendations made by these CFR and State Department officials.

One commonly-held belief was that planning should start early. US postwar planning was underway by the summer of 1939, more than two years before the United States went to war. The agenda was unfocused and leisurely, but it provided a solid basis

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<sup>65</sup> Dean and Foreign Policy Association, *The Struggle for World Order*, 50.



on which future relationships would build.<sup>66</sup> Early planning was also kept confidential; the Roosevelt administration sought to develop political unity before the public discussion was started.<sup>67</sup> There was still extensive isolationist resistance to US involvement in European affairs. There was concern on the part of the president that US public opinion would backfire against US involvement in a European war if postwar planning if it became public to early.<sup>68</sup>

Another common belief among planners was that nations should strive to provide their citizens with a high standard of living in the postwar period. Despite the claims of superiority, neither German Fascism nor Soviet Communism was able to provide a higher standard living for their citizens.<sup>69</sup> US planners placed great emphasis on a “social objective.” It was incumbent on governments everywhere, as expressed by Roosevelt’s Four Freedoms Speech, to create conditions of economic security and higher levels of individual well-being.<sup>70</sup> In a speech delivered in 1942, Dr. Leo Pasvolsky, proclaimed that once the earth is freed from the menace of these sinister forces, international relations will have to be organized in such a way as to ensure the economic and social welfare for individuals everywhere and to create international economic conditions that will make possible an efficient utilization of human and material resources of the world to maintain a measure of employment and rising standard of livings everywhere.<sup>71</sup>

During WWII, there was a great increase in the role of economists and economic planning at the State Department. Officials thought that the US public was more likely to

<sup>66</sup> Smith, *American Empire*, 331.

<sup>67</sup> Penrose, *Economic Planning for the Peace*, 12.

<sup>68</sup> United States Department of State, “Foreign Relations of the United States Diplomatic Papers, 1942. General; the British Commonwealth; the Far East,” 1942, 201, <http://digicoll.library.wisc.edu/cgi-bin/FRUS/FRUS>.

<sup>69</sup> Dean and Foreign Policy Association, *The Struggle for World Order*, 56.

<sup>70</sup> Pasvolsky, *The Problem of Economic Peace after the War.*, 8.

<sup>71</sup> *Ibid.*, 2.

support international economic collaboration than international political collaboration.<sup>72</sup> Starting in the 1930s, government officials had given extensive consideration to international economic policy and, from that time on, were focused on providing economics solutions to postwar problems.<sup>73</sup> In 1942, Secretary Hull commented that the most important feature of postwar planning was to build sound international commerce.<sup>74</sup> Taking these considerations into account, early planning focused on developing a vibrant international commercial community as a cornerstone for an enduring peace.

State Department planners unanimously believed that the United States should occupy the dominant position in the postwar world. The United States would finally accept its global responsibility over matters vital to US security interests.<sup>75</sup> Planners believed in an expanded geographic area of economic development, a “Grand Area” covering the Western Hemisphere, large portions of Europe, Asia, and include the defeated Axis powers of Germany and Japan.<sup>76</sup>

US planners believed that the United States would play the decisive role. A wide variety of officials believed that US foreign economic policy would be the crucial player in the postwar world.<sup>77</sup> They believed that an increasing number of world leaders understood that the influence of the United States would be decisive after the war. The views of the United States on economic relations would have to be accepted by the rest of the world.<sup>78</sup>

<sup>72</sup> Penrose, *Economic Planning for the Peace*, 360.

<sup>73</sup> Notter, United States, and Department of State., *Postwar Foreign Policy Preparation, 1939-1945.*, 1949, 23.

<sup>74</sup> State, “Foreign Relations of the United States Diplomatic Papers, 1942. General; the British Commonwealth; the Far East,” 202.

<sup>75</sup> Shoup, *Imperial Brain Trust*, 163.

<sup>76</sup> *Ibid.*, 168.

<sup>77</sup> Gaddis, *The United States and the Origins of the Cold War, 1941-1947/*, 18.

<sup>78</sup> State, “Foreign Relations of the United States Diplomatic Papers, 1940. General,” 31.

The State Department reaffirmed US anti-cartel policy. Americans commonly believed that industrial cartels, monopolies, and trusts violated the public interest.<sup>79</sup> Postwar planners heartily agreed with American policy against this form of market control. A number of European countries did not possess a similar tradition against cartels; conversely, many countries, especially Germany, encouraged cartels. German firms like I.G. Farben, used cartels to further Nazi goals.<sup>80</sup> State Department officials were determined that the defeat of the Nazi armies must be followed by the eradication of these weapons of economic warfare. German industrial cartels would have to be broken up and their political activities stopped.

State Department planners also held a common view on reparitions. Both the United States and Great Britain were in favor of a smaller amount of reparation payments, whereas the French and Soviets were likely to ask for large reparation payments. US policy for post-WWII German reparation payments would need much consideration. The early leadership of the United States in formulating a reasonable settlement was critical.<sup>81</sup> Developing a reparations figure by adding up the costs of restoring the wealth of all German victims would have led to an astronomical amount far in excess of Germany's ability to pay. Because of this, the assessment of German reparation payments should not be a matter of justice and rights but one of economics and politics. Not only would Germany's ability to pay have to be considered but also the effects of reparation payments on all sectors of the receiving country. As William Diebold, Jr., Research Secretary for the Council of Foreign Relations Economics Group,

<sup>79</sup> Council on Foreign Relations, *Postwar Controls of the German Economy*, 14.

<sup>80</sup> United States Department of State, "Foreign Relations of the United States Diplomatic Papers, 1944. General: Economic and Social Matters," 1944, 72, <http://digicoll.library.wisc.edu/cgi-bin/FRUS/FRUS>.

<sup>81</sup> William Diebold and Council on Foreign Relations, *What Shall Germany Pay? The New Reparations Problem., Its American Interests in the War and the Peace*; (New York, 1944), 3.

agued in “What Shall Germany Pay,” it was in the long-run interests of the allied powers to preserve a valid economy in Germany. It was important that the United States develop a postwar position and that the position be wise and farsighted. Many countries, especially the USSR, would pursue heavy reparations.<sup>82</sup> The United States and Great Britain would have to struggle to promote a moderate and practical reparations program for the good of international commerce.

### Building a Multilateral World

The haunting specter of a reoccurring depression caused postwar planners to pay close attention to the critical relationship between international and domestic economics. A new global order based on economic integration was justified by the disastrous history of the 1920s and 1930s.<sup>83</sup> Planners tied the prosperity of the American economy very closely to the outside world. They held a common conviction that a loss of large export markets would again cause a lowering of national income and a growth in unemployment as it had during the interwar period.

The State Department envisaged a radical change in global international relations; their design emphasized an increase in prosperity by widespread use of multilateral trade. In a speech delivered in July 1940, Secretary Hull declared, “General postwar rehabilitation would depend on the revival of international commerce with liberal trade principles.”<sup>84</sup> No nation can provide the necessities of modern life for its own people if it has access solely to its own resources. A group of nations cannot attain a high level of well-being in isolation. To be able to trade one nation’s surplus for the production of

<sup>82</sup> Ibid., 1.

<sup>83</sup> Shoup, *Imperial Brain Trust*, 163.

<sup>84</sup> Notter, United States, and Department of State., *Postwar Foreign Policy Preparation, 1939-1945.*, 1949, 34.

another nation's surplus does not necessarily mean unrestricted trade in the sense of an absence of any regulation, but expanding economic prosperity does require a large measure of flexibility in trade movement. International trade develops prosperity when it is multinational in nature.<sup>85</sup> The creed of liberalized trade driven by multilateralism was to be a driving force in State Department policy and to have a deterministic effect of postwar occupation policy in Germany.

With the end of WWII, a new opportunity presented itself. The State Department saw the collapse of Germany as a chance to implement its economic policy recommendations on an international scale. They were firm in their belief that it would eliminate the possibility of a reoccurring depression. They held their eyes firmly on postwar Germany as a unique proving ground for the planning in which they held so much faith.

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<sup>85</sup> Pasvolsky, *The Problem of Economic Peace after the War.*, 5.

## Chapter II

### 1939–1944: Early Postwar Planning

#### Two Agencies Set the Agenda

The US State Department and the Council on Foreign Relations (CFR) were the two major contributors to early planning for postwar Germany. Initial groundwork was started at the CFR with the blessing of President Roosevelt and Secretary Hull.<sup>1</sup> Their planning started in 1939, two years before the United States became involved in the war. By 1942, the planners at the CFR became officially integrated into the State Department. In 1944, other governmental departments became involved in postwar planning, but their work was done without regard for previously completed State Department proposals. Although officials within the State Department held a variety of ideas about the postwar occupation of Germany, there was a consensus on the main goal of global multilateralism.

#### The CFR War and Peace Studies

The CFR was founded in 1921 in New York as the nation's leading foreign policy think tank; it stood at the apex of liberal internationalism and provided a seedbed for US foreign policy. The operation and interests represented by the CFR were overwhelmingly from the East Coast elite, including businessmen, lawyers, and technocrats.<sup>2</sup> Membership was confined to influential people who shared an internationalist perspective, one that

<sup>1</sup> Harley A. Notter, United States, and Department of State., *Postwar Foreign Policy Preparation, 1939-1945.*, Department of State Publication ;; 3580.; General Foreign Policy Series ;; 15; (Washington , U.S Govt. Print. Off., 1949), 69.

<sup>2</sup> Shoup, *Imperial Brain Trust*, 152.

linked national interests with the interests of the US business class.<sup>3</sup> The idea behind the CFR, like its British sister organization Chatham House, was to establish a platform from which to construct a well-informed public opinion. Public opinion would then be channeled to support changes in governmental policy.<sup>4</sup> Considering the emerging status of the United States, the CFR's policy recommendations were distinctly liberal with the objective of opening up the entire globe for economic interaction.

The need for an organization like the CFR developed from the institutional inadequacy of the American governmental to formulate a reasoned international policy. US foreign policy in the early twentieth century was weak and incoherent. A lack of national purpose caused mistrust by foreign governments and a failure to develop a strong international presence. The CFR started as an institution that intended to redress the American political realities of local-based constituents and pork-barrel patronage whose outlook stopped at the nation's border.<sup>5</sup> Studying society through an emerging technique of combining academic social science and business expertise, the CFR associated itself with federal agencies and then advocated for solutions to deep-seated international problems. If the United States were to take its rightful place and fulfill its mission as a world leader, it would need a foreign policy that was internationally orientated as well as bipartisan. The nation's strong isolationist attitude was inward looking and out of date; the United States needed to expand its policy perspectives to internationalism. To accomplish this, the electorate would have to be united behind a

<sup>3</sup> Neil Smith, *American Empire: Roosevelt's Geographer and the Prelude to Globalization*, California Studies in Critical Human Geography ;; 9; (Berkeley: University of California Press, 2003), 192.

<sup>4</sup> Ibid., 195.

<sup>5</sup> Parmar, "The Role of the Council on Foreign Relations," 338.

modern political attitude.<sup>6</sup> With the emergence of a global crisis in the 1930s leading to the start of WWII, the CFR saw an opportunity to inject itself into the US foreign policy by creating a structure and improving the cooperation among nations through the expansion of international commerce.

The influence of the CFR was significant in that its proposed concept of an expanded national interest, through international commercial development, eventually became the foundation of State Department foreign policy. The basis for discussion of the post-WWII national interest was first defined within an economic framework, focusing on long-term economic trends that would benefit the United States. The national interest was coupled to a “Grand Area,” identifying which foreign interests and regions of the world would best satisfy US needs.<sup>7</sup> Through the CFR, the American business class became the dominant influence in the proposed expansion of American influence overseas. Based on a policy of open access to raw materials and markets, this opportunity, one that was expected to establish an environment of peace and prosperity, was extended to all nations of the world.

The CFR formulated a process for the development of policy; it centered on a study group of experts and researchers.<sup>8</sup> The process involved four stages: determination and analysis of anticipated problems engaging US interests; consideration of alternative solutions for these problems; selection of the preferred solution and its formulation as a policy recommendation; and a decision on policy recommendations that constituted the

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<sup>6</sup> Ibid., 340.

<sup>7</sup> Ibid., 349.

<sup>8</sup> Shoup, *Imperial Brain Trust*, 173.



position taken by the United States in international negotiations.<sup>9</sup> At the onset of WWII, the CFR was better positioned than any other US interest group to influence the foreign policy structure of the US government.

In 1939, it seemed clear that the future interests of the United States would change. Members of the CFR and their acquaintances at the State Department saw this development as an unparalleled opportunity. In early September of that year, Hamilton Armstrong Fish, Editor of Foreign Affairs, and Walter H. Mallory, Executive Director of the CFR, paid a visit to the State Department to offer their assistance. The CFR could provide the State Department with research data and expert opinion to supplement official policy. State Department officers welcomed Fish and Mallory and encouraged them to generate a detailed plan. In December 1939, the CFR established the War and Peace Studies Group under the direction of four general committees: Security and Armaments, Political, Territorial, and Economic and Financial.<sup>10</sup> Over the life of the War and Peace Studies Group, 1939 to 1945, a total of 682 documents were prepared for and sent to the State Department for consideration.<sup>11</sup> The most prolific of these study groups was the Economic and Financial Committee, highlighting the importance that the CFR placed on the economic policy as the basis for the postwar policy.

Membership on the War and Peace Studies Group led to other work directly related to the settlement of postwar problems, and most members were in both the CFR and the US State Department. The CFR claimed that its members “were better prepared to carry out their official duties as a result of having given long and specialized study to

<sup>9</sup> Notter, United States, and Department of State., *Postwar Foreign Policy Preparation, 1939-1945.*, 1949, 2.

<sup>10</sup> Council on Foreign Relations, *The Council on Foreign Relations; a Record of Twenty-Five Years, 1921-1946* (New York: s. n., 1947), 16.

<sup>11</sup> *Ibid.*, 22.

the problems of postwar settlement.”<sup>12</sup> The list of US State Department employees who were both members of the CFR and closely involved in official postwar planning included Undersecretary of State Sumner Welles, Norman Davis, Isaiah Bowman, Dr. Leo Pasvolsky, Hamilton Fish Armstrong, Dean Acheson, William Diebold, Jr., and Adolf Berle.<sup>13</sup> Although this group of co-members did not include Hull, every other major State Department official who had influence over early postwar planning was also a member of the CFR.

Between 1939 and 1942, the links between the CFR and the State Department became increasingly interwoven. In February 1941, the CFR added a Division of Special Research and appointed a State Department official, Dr. Leo Pasvolsky, its director. This close working relationship was further strengthened in 1942 when the State Department organized the Advisory Committee on Postwar Foreign Policies (ACFPF) under the direction of Hull. Welles was appointed its vice chairman and Pasvolsky its executive officer.<sup>14</sup> This was essentially a transfer of the CFR postwar planning structure to the State Department. Completely absorbed and reinvented in the State Department, the War and Peace Studies Group was effectively transformed from a private entity to a governmental operation and placed at the head of the State Department policy formulation apparatus.<sup>15</sup> The transfer of membership from the CFR to the ACPFP meant that the objectives of the CFR became the objectives of the State Department.

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<sup>12</sup> Ibid.

<sup>13</sup> Shoup, *Imperial Brain Trust*, 152.

<sup>14</sup> Council on Foreign Relations, *The Council on Foreign Relations; a Record of Twenty-Five Years, 1921-1946*, 19.

<sup>15</sup> Smith, *American Empire*, 330.

## The ACPFP

On December 22, 1941, Hull sent a letter to Roosevelt confirming that in accordance with the president's desire, a special committee known as the Advisory Committee on Postwar Foreign Policies had been created to prepare for the countries participation in the resolution of international problems that would likely confront the United States after the defeat of the forces of aggression. This committee would be charged with studies and recommendations that would be submitted to the president. The purpose of the ACPFP was to establish and maintain contact with all appropriate departments of any governmental and non-governmental agencies that were in a position to contribute. Hull further stated that "all conversations or negotiations with foreign governments bearing on postwar problems be conducted, under your authority, by or through the Department of State."<sup>16</sup> The ACPFP advised in the fields of security, economics, and other fields requiring international cooperation.<sup>17</sup> The ACPFP established a framework for all postwar decisions concerning America's economic relationship with the rest of the world.<sup>18</sup> With the creation of the ACPFP, postwar planning became the exclusive domain of the State Department. At this early date, there was no interdepartmental debate of postwar policy. The State Department, which was heavily influenced by internationalist economic policy, was free to develop its own vision. This did not mean that their policy positions would later be accepted, but it did mean that they had a head start over other departments and were able to spend the necessary time to devolving a plan based on reason.

<sup>16</sup> United States Department of State, "Foreign Relations of the United States Diplomatic Papers, 1941. General, The Soviet Union," 1941, 595, <http://digicoll.library.wisc.edu/cgi-bin/FRUS/FRUS>.

<sup>17</sup> Ibid.

<sup>18</sup> Shoup, *Imperial Brain Trust*, 150.

During the initial phase of discussion between 1939 and 1943, the outcome of the war had not yet been determined. Although a complete victory was not assured, planners assumed that the United States would be a principle power after the war and would accept major responsibility for determining the character of the postwar world. It was understood that the preparation for peace would take much time and need careful consideration.<sup>19</sup> The nature and character of postwar states and their international relationships were at the core of the ACPFP discussions. There was a concern that a hastily developed plan, like those later developed in 1944 at other branches within the US government, would repeat the same bad outcome of the post-WWI period. To avoid repeating the same mistakes made after WWI, a fundamental change—one built on economic interdependence at mutual prosperity—was needed in the structure of international relationships.

Committee discussion was flexible, not rigid or preconceived, and membership was becoming more diversified. By 1943, the work of the committee started to bring in personnel from other cabinet level departments, including several officials with interlocking committee memberships. The ACPFP added members from the houses of Congress, the State, Treasury, and War Departments, the Executive Branch, and private citizens. During this period, Hull was sick and spent much of his time out of Washington. In Hull's absence, Welles held the committee under close supervision and control.<sup>20</sup> The absence of Hull during this period left an open position at the State Department in which Welles was eager to fill. Policy discussions led by Welles and other important members,

<sup>19</sup> Notter, United States, and Department of State., *Postwar Foreign Policy Preparation, 1939-1945.*, 1949, 69.

<sup>20</sup> Christopher D O'Sullivan and Gutenberg, *Sumner Welles, Postwar Planning, and the Quest for a New World Order, 1937-1943* (New York: Columbia University Press, 2008), 35.

like Bowman, still centered on the application of multilateralism; however, the treatment of Germany still posed a unique problem as committee members took a position either in support of or in opposition of the partitioning of Germany. Hull's State Department as a whole, even in his absence, held firm on supporting international multilateralism and approached German prosperity not as a pro or con but how German prosperity would fit into a prosperous international economic structure.

The goal of the ACPFP was to find a nonpartisan agreement on foreign policy and a harmony of views between the Executive and Legislative branches. Policy recommendations were to be coordinated by Welles and Pasvolsky, and then passed on to Roosevelt through Hull. "The president desired to be able to reach in his basket and to find whatever he needed in regard to postwar foreign policy and meantime wished to devote himself wholly to ways and means of winning the war."<sup>21</sup> It would be left to the ACPFP committees to determine the type of policy the United States wanted for the postwar period. During this period, Roosevelt gave little guidance or indication to the committees as to his policy preferences, and even though committee members turned out large amounts of memos and position papers, he never used much of it in preparation for high-level conferences at Teheran and Yalta.

The most important of the ACPFP committees was the economic subcommittee headed by Pasvolsky. Pasvolsky was Hull's favorite, a Russian born trade expert who immigrated to the United States in 1905 and joined the State Department in 1934.<sup>22</sup> Just like Hull, Pasvolsky was committed to an international order based on multilateralism.

<sup>21</sup> Notter, United States, and Department of State., *Postwar Foreign Policy Preparation, 1939-1945.*, 1949, 79.

<sup>22</sup> Kenneth Weisbrode, "The Master, the Maverick, and the Machine: Three Wartime Promoters of Peace," *Journal of Policy History* 21, no. 4 (October 2009): 368.

Membership on the economic subcommittee also included Adolf Berle, Norman Davis, Dean Acheson, and Dexter White. On March 6, 1942, the Economic Subcommittee held its first meeting to consider Article VII of the Lend-Lease Agreement and the comparative merits of bilateral and multilateral approaches to their implementation. The main point of agreement among committee members was that pursuant to the Lend-Lease agreement, all signatures that received lend-lease aid must, as a quid pro quo arrangement, develop policies for the elimination of discriminatory trade practices and trade barriers.<sup>23</sup> In 1942, under the direction of Hull, the State Department's main concern for the postwar period was to rid the world of trade barriers. The State Department believed that nations, like Great Britain, in critical need of aid and very resistant to the potential loss of its trade preference, must as part of any lend-lease agreement include a quid pro quo for their elimination of all discriminatory trade practices.

#### Policy Papers Produced by CFR and ACPFP Members

From 1941 to 1944, officials from the ACPFP and the CFR composed and submitted a number of policy papers and recommendations for the postwar period. Many of these directly affected economic policy and were influential during the upcoming German occupation. The ideas and policies in the three papers discussed in this section expressed the views of the State Department and were considered to be rational and carefully planned. These papers called for the development of a prosperous commercial policy, the elimination of industrial cartels, and a reparation policy that would benefit both the giving and receiving nations. The ideas addressed in these three position papers

<sup>23</sup> Notter, United States, and Department of State., *Postwar Foreign Policy Preparation, 1939-1945*, (1949), 84.

would later come under attack from Executive, Treasury, and War Department officials as part of an interdepartmental conflict. Although the policy recommendations of the ACPFR in 1944 had a striking similarity to the eventual policy arrived at by the late 1940s, the following recommendations were challenged by situational problems during the military occupation period and tested as Cold War tensions grew between the United States and the Soviet Union.

Percy W. Bidwell, a member of both the CFR and the War and Peace Studies Group and an advisor to ACPFP, wrote a policy paper in 1944 entitled “Postwar Controls of the German Economy.” Bidwell recommended that policy should not be vengeful but targeted at promoting German prosperity. Compensation for victims of German aggression and procedures for disarmament should be designed to lay the foundations for recovery on an international scale. “The victors should reject measures designed to reduce Germany to a position of permanent economic inferiority. On the contrary, they should plan their policy so as to make possible eventually receiving the defeated nation, if its behavior in the interim is satisfactory, on equal terms into the international organization.”<sup>24</sup> Bidwell emphasized that his liberal policy recommendations would require the victor nations to devote themselves to the prevention of further German aggression over a period of time. In addition, to implement a liberal commercial policy for Germany, it would be necessary to ensure Russian collaboration with both the United Kingdom and the United States. Failing such collaboration, a Russo-German rapprochement would seem certain.<sup>25</sup> Bidwell proposed that the United States seek a

<sup>24</sup> Council on Foreign Relations, *Postwar Controls of the German Economy*, 1.

<sup>25</sup> *Ibid.*, 2.

collaborative policy with its Allies and be willing to stay in Germany for however long it would take.

Bidwell further recommended that economic hostility should not be continued after military hostilities have ended. Within three months of surrender, the naval blockade of German ports should be lifted. Germany at once should be accorded most-favored-nation status from each of the United Nations, and German tariffs should be lowered to make their economy more interdependent with the world. With allied cooperation, a lengthened occupation would be unnecessary, reducing burdensome occupation costs and speeding up economic recovery.<sup>26</sup> Allied occupation policy should not weaken German production but should be used to serve the restoration of a vigorous economic life in those European countries that depend on German markets and supplies. All postwar rules of occupation should seem evenhanded to the German people and not breed resentment. Economic controls would not be self-enforcing; they would require the constant diligence of victor nations.<sup>27</sup> The United States must be careful that the implementations of controls do not arouse rivalry and friction between Allied nations in the event that economic gains become unequally distributed.

The redevelopment of German industries might be objected to because it was believed that peacetime industries could be converted back to war type production. This was not a valid concern because conversion was a time-consuming process and could not be carried out openly in postwar German on a large scale. Dismantling war industry did not mean destroying industry. Germans should be permitted to salvage the plant equipment from their armaments industry that could be converted to peacetime

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<sup>26</sup> Ibid., 6.

<sup>27</sup> Ibid., 19.



production uses.<sup>28</sup> The remedy for the postwar was not the imposition of rigid limitations but the establishment of flexible general conventions dealing with commercial policy of which Germany must subscribe.<sup>29</sup> The recommendations of this policy paper reflect a liberal approach to the treatment of postwar Germany; these ideas were uniform with the line of thought at the State Department but would run into future challenges from other sectors of the government.

Arthur Gayer and Alvin Hansen, members of both the CFR and the War and Peace Studies Group and contributors to the ACPFP, wrote a policy paper in 1944 entitled “The Control of International Cartels.” This paper outlines important recommendations for postwar commercial policy pertaining to industrial cartels in Germany, and highlights the unyielding position of the US State Department in opposition to industrial cartels. The paper warns that if the United States continues to pursue its traditional isolationist policy, we shall see a persistent development of international cartels from which American firms will be excluded. Further, the effect of WWII will be to reinforce the tendencies toward cartelization because a pursuit of expansive policy will create excess productive capacity and the ability to dump products overseas.<sup>30</sup> The State Department placed a great emphasis on the danger of German industrial cartels, and felt that if they could not be eliminated they should be regulated into a free and prosperous system.

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<sup>28</sup> Ibid.

<sup>29</sup> Ibid.

<sup>30</sup> Arthur D. Gayer and Council on Foreign Relations, *The Control of International Cartels*. Its American Interests in the War and the Peace; New York, Council on Foreign Relations, 1944, 9.

The authors recommended that an international agency should be established in which industrial cartel type agreements would be filed, disclosed, and regulated.<sup>31</sup> This agency would have authority over more than just one industry, and controls over cartels would be made on a case-by-case basis.<sup>32</sup> The overall goal was that specific cartel agreements were only allowed if they were mutually beneficial and fit a scheme of an expansive international economy.<sup>33</sup> Most industrial cartel agreements crossed national borders. Nations in the past often felt that they needed to join in or be left out; therefore, cartel arrangements should be negotiated alongside tariff reductions as both policies cross national borders and are complimentary of each other.<sup>34</sup>

The key factor in postwar was reparation policy. William Diebold, Jr., a member of both the CFR War and Peace Studies Group and an advisor to ACPFP, wrote a paper in 1944 entitled “What shall Germany Pay? The New Reparations Problem,” Diebold warned that a danger would have existed if reparation policy were influenced by political and military circumstances and not the most efficient and expansive economic policies. German goods and services would be transferred to claimant countries only if certain conditions are met and skillful management is exercised.<sup>35</sup> Diebold recommends that reparation policy should conform to the following principles: reparations should only be imposed to the extent that they contribute to the strengthening of the postwar world economic order; there should be no financial reparations; the amounts of goods and services that are removed should be limited; obligations should be stated in specific

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<sup>31</sup> Ibid., 26.

<sup>32</sup> Ibid., 1.

<sup>33</sup> Ibid., 3.

<sup>34</sup> Ibid., 10.

<sup>35</sup> William Diebold and Council on Foreign Relations, *What Shall Germany Pay? The New Reparations Problem., Its American Interests in the War and the Peace*; (New York, 1944), 1.

amounts and specific types; the duration of the reparation period should be short; and reparations should not be relied on as a major instrument of control over Germany.<sup>36</sup>

Diebold's paper calls for the creation of a United Nations Reparations Commission to formulate and coordinate a policy. The commission should decide whether such goods could be supplied from Germany without impairing the efficiency of the German productive plant below a certain level or reducing living standards below a certain level. Diebold expected that the Russian government would put forth a strong demand for reparations. Early estimates of legitimate Russian needs reached 200 billion dollars.<sup>37</sup> At this time, Russia must recognize that full compensation could not be expected from Germany. At Tehran Stalin asked for 20 billion, an amount for which Roosevelt would not guarantee. From the Russian point of view, reparation payments should have been made to those whose damage was the largest as compared to their total national wealth. They were expecting that payments could be made in kind or in the form of manpower labor provided by German workers. Contrary to the Russian position, the British did not want to repeat the problem created by the last war, and consequently, they were not looking for any significant reparation payments.<sup>38</sup>

The State Department appreciated that the postwar German economy would be in a delicate condition; a harsh reparation policy would cause serious harm not only to Germany but all of Europe. State Department planners understood that like any other type of foreign debt, reparation obligations could be repaid only by exporting more than was imported or by liquidation of foreign assets. The total value of Germany's foreign assets was not great in comparison to the amounts of reparations sought. To pay reparations by

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<sup>36</sup> Ibid., 3.

<sup>37</sup> Ibid., 7.

<sup>38</sup> Ibid., 8.

exporting without receiving anything in return reduced the funds available to Germany for investment, consumption, and commercial materials.<sup>39</sup> If the goods, capital equipment, and labor payments to be transferred were not chosen carefully, the reparations process could have had bad consequences for both Germany and the receiving nations.<sup>40</sup> Under a wise reparations plan, Germany would recover slower but would be working at full capacity gearing its reparations into Europe's general economic expansion. The fulfillment of Germany's own economic requirement could be managed and timed until it would help take up the slack in demand following an expected postwar boom.

Diebold placed a great deal of emphasis on how a reparation plan should be designed. It is important to understand that for the State Department, the purpose of reparations was to jump-start the whole European economy and not for the benefit of any one nation. The types of goods used to make payments would be crucial to both Germany and the receiving nation. Unless reparations in the form of goods received are of a kind that would have to be imported anyway, reparations would likely depress the receiving nation's economy. A poorly planned reparations program could also adversely affect the economy of a third party nation. The types of goods exported from a debtor country can make a significant difference; it would have been advisable for reparations to be paid with goods in which Germany had a competitive advantage.<sup>41</sup> A heavy reparations bill would have a negative impact and would put an unreasonable low ceiling on the living standards of Germany, while a lighter reparations bill would have been a positive

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<sup>39</sup> Ibid., 10.

<sup>40</sup> Ibid., 15.

<sup>41</sup> Ibid., 12.

influence and produced a core of demand that could have stimulated the German economy.

During the immediate postwar period, the Soviet Union removed large quantities of capital equipment. In 1944, Diebold questioned the desirability to Russia and other receiving nations of taking capital equipment as a form of reparations. At the end of the war, much of Germany's equipment would be old and in need of maintenance or obsolete and inefficient. It is possible that capital equipment gained in the form of reparation payments could fill the immediate need until newer equipment could be procured. From Germany's point of view, the loss of its older capital equipment could clear the way for new and modern equipment and might secure an advantage over the receiving countries that would not have the same need to modernize.<sup>42</sup> The very nature of reparations went against the grain of planning for prosperity. The State Department understood how difficult it was to take capital equipment from one economic environment like Germany, and successfully transplant it into another foreign economic environment like Russia.

State Department recommendations by Diebold and others dictated that German reparation policy be determined by considering its effect on the overall world economy, not on the positive or negative effect on just one country. Obligations of defeated nations should be based on their abilities and usefulness, not a total owed.<sup>43</sup> If Europe was to become economically viable after the war, Germany's reparations needed to be light enough to permit this. Reparations should be used in such a way as to promote rapid recovery and to be managed on the basis of what can be achieved rather than bowing to political pressure.

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<sup>42</sup> Ibid., 18.

<sup>43</sup> Ibid., 28.

### Isaiah Bowman, the Attainment of American Economic Lebensraum

Isaiah Bowman and Sumner Welles were two high-level State Department policy makers deeply involved in formulating postwar German policy. Both agreed with the basic principles of multilateralism and universal prosperity, but their ideas and ambitions for Germany, in particular, were in direct conflict with each other.

Isaiah Bowman was a key figure in the development of postwar policy for both WWI and WWII. As head of the American Geographical Society for twenty years, his expertise in territorial matters was highly prized by the US State Department. He was also a member in high standing at the CFR, serving as its director and vice-president over the duration of his membership. Bowman's work as a State Department postwar planner began in 1940, two years before the United States was in the war. He had become a major influence in the process of freeing the colonies of the European powers and opening them up for US commercial development.<sup>44</sup> As WWII progressed, Bowman, like others at the State Department, came to realize that territorial issues should be considered less important compared to immediate military questions and postwar economic considerations. This approach conflicted with the views of Roosevelt and his closest advisors who believed that settling European accounts would come before the development of a broader State Department's priority for a "New World Order."<sup>45</sup> Bowman's fundamental ideas about postwar planning coincided with most other members of the CFR and the State Department, although strong differences arose predominately over policy concerning a proposed German partition.

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<sup>44</sup> Smith, *American Empire*, 320.

<sup>45</sup> Ibid.

Bowman saw the need for a change in US foreign policy based on the Russian Revolution in 1917 and not the rise of the Nazis in 1933. For Bowman, the rise of a Communist Soviet Union became a lightning rod for the emergence of a new liberal foreign policy. The United States could no longer count on its good intentions to keep it safe and prosperous. US foreign policy needed a gradual revolution toward a new liberal internationalism.<sup>46</sup> The new type of liberal internationalism proposed by Bowman would involve a change of perspective; global organization after WWII should be based on economic markets and not on occupied territory. Rather than a 1919 type World Order based on geopolitical arrangements; the post-WWII version of a New World Order should be based on economic arrangements. In a world of declining empires, Bowman foresaw an “American Economic Lebensraum.”<sup>47</sup> Control of economic resources, like raw materials, workforces, and markets, was the direct key to national survival and growth. Rather than measuring global power by an accumulation of territory, the new global nexus would be established by trade and market share.

In the interwar years, Bowman was involved in an academic conflict with the German geographical community. At international geographical conferences during the early 1930s, Bowman openly expressed his concerns over the nature of German geopolitics. At the time, he saw the rapid growth of a geopolitical pseudoscience in German academia based on false notions of national territories. German geographical academics were developing a preconceived system of political geography and making facts conform to it. Bowman recognized this nationalist scheme in German political geography. The Germans thought of the state as an organism apart from individuals that

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<sup>46</sup> Ibid., 204.

<sup>47</sup> Ibid., 318.

compose it. They spoke in terms of the rights of the state and the progressive development of the state.<sup>48</sup> In the late 1930s, Nazi propagandists added to the concept of an expanded German *Lebensraum* by developing *Grosswirtschaftsraum* (greater economic sphere), the argument that every great power had at its disposal vast territory on which to develop its economic system. Great Britain and France had their colonies, the United States and the Soviet Union had vast frontiers, and Japan had secured territory in Asia. It was only a powerful Germany that had been confined to an undersized and overpopulated space.<sup>49</sup>

Ideas about postwar international territorial organization fit into two different groups: regionalism and globalism. Regionalism, in which Roosevelt, Churchill, and Welles were advocates, was an idea that nations within a certain geographical region would band together to coordinate policy. Each region of the world would be policed by a superpower. There still could be an international organization, but it would do little more than coordinate the work of the regional organizations. Globalism, the other faction whose advocates included Hull, Pasvolsky, Bowman, favored a single strong global based organization to coordinate all policy. Early in the debate process, regionalism promoted by Welles, was on the ascent; but by the summer of 1943, with the persuasive power of Bowman, views at the State Department were changing; most influential people were now in favor of a globalist system. Hull felt that he and Bowman had also been successful in changing Roosevelt's point of view, and was confident enough to state in his November 18, 1943 address to Congress that there would no longer be a need for spheres of influence, alliances, or balance of power. The great powers must act together

<sup>48</sup> Geoffrey J. Martin, *The Life and Thought of Isaiah Bowman* (Hamden, Conn: Archon Books, 1980), 165.

<sup>49</sup> Einzig, *Hitler's "New Order" in Europe.*, 5.



toward a single goal of a United Nations organization.<sup>50</sup> It seems that Bowman and the State Department were successful in changing US postwar planning toward a policy that relied less on territorial possessions and more toward a market driven economic scheme of global expansion. In late 1943, at the conference in Tehran between the three major Allied powers, Stalin was prepared to press his territorial demands, but the US State Department back in Washington was developing their own global scheme based on a single global network of economic integration that extended beyond territorial borders.<sup>51</sup>

#### Sumner Welles, Europe, and Early Proposals for World Design

During WWII, Welles—a man whose vision would push the US postwar transformation from a major power to a superpower and an architect of the coming “American Century”—became Roosevelt’s chief spokesman on foreign affairs. Welles, a self-professed internationalist, endeavored to promote the needs of an expanding American economy. His close personal ties to Roosevelt, along with the marginalization of Hull’s within the administration, enabled Welles to play a more pivotal role in postwar planning than he might have otherwise enjoyed.<sup>52</sup> In 1937, Welles was appointed Undersecretary of State and took full advantage of his situation. At the time, he was 45 years old, energetic, ambitious, and a long-time friend of Roosevelt. In contrast, Hull was 66 years old and in poor health. Welles, a well-traveled linguist, seemed a better fit to lead the State Department than Hull, who spoke only English and never left the United

<sup>50</sup> Hull, *The Memoirs of Cordell Hull*, n.d., 1640.

<sup>51</sup> Smith, *American Empire*, 380.

<sup>52</sup> O’Sullivan and Gutenberg, *Sumner Welles, Postwar Planning, and the Quest for a New World Order, 1937-1943*, XIV.

States.<sup>53</sup> Welles' philosophy at the State Department was that the US foreign policy should be based on enlightened self-interest. He put emphasis on long-range plans, establishing a New World Order and an international organization that would provide peace and security. His policy was designed to be proactive, expand trade relations, and improve relations with the Soviet Union.<sup>54</sup> Welles personified the approaching vision of the US State Department, but his forceful style ran against the grain of Hull's authority.

When Welles entered office, he began a sweeping reorganization of the State Department. In a pre-Churchill era (1937–1940), he pushed US foreign policy into an activist anti-Nazi agenda and continued to search for ways for Washington to play a more active role in the European crisis and develop closer ties to the Soviet Union. Welles, unlike the rest of the cabinet, was one of the few administration officials to openly support Roosevelt's proposed use of pre-war economic pressure to combat aggressor nations, like Germany and Japan.<sup>55</sup> Welles' foreign policy influence crossed department lines, as he was an important figure in both the State Department and the Executive Branch of the government.

After his appointment, Welles became the driving force behind the administrations reorientation of foreign policy, which included an assumption of US leadership for collective security, a free trade policy, and the calling of regular international conferences to coordinate US interests. In 1937, he pressed for Washington to act affirmatively toward German aggression in Europe. He thought that Hitler was not acting in its long-term interests but on a case-by-case basis. He developed the Welles

<sup>53</sup> Benjamin Welles, *Sumner Welles: FDR's Global Strategist: A Biography*, 1st ed (New York: St. Martin's Press, 1997), 199.

<sup>54</sup> Welles, *The Time for Decision*, 401.

<sup>55</sup> Welles, *Sumner Welles*, 204.

Plan, which called for diplomatic conferences and international economic measures to combat aggression in an early demonstration of US/Allied unity. Welles intention was to send a message to the world that the United States was going to play a more assertive role in world affairs in an effort to discourage German aggression. Hull, along with many at the State Department, rejected Welles' proposals on the basis that they were too aggressive.<sup>56</sup> Despite an American public that seemed to support isolationism and a State Department to timid to act, Welles continued to speak publicly of a proactive United States pursuing a New World Order.<sup>57</sup> Welles was Roosevelt's right-hand man at the State Department, and with Hull's deteriorating health, there was an influential position open for Welles to fill.

The uneasiness between Welles and Hull had more to do with personality than with policy. Welles and Hull were in agreement on most State Department policies. Both believed that the United States must change its international image characterized by the Monroe Doctrine. They felt that the US foreign policy had been based on unilateralist scheme, aroused legitimate suspicions, and prevented growth of inter-American interests. In a postwar world, the United States can no longer maintain a unilateral approach and limit itself to the Western Hemisphere. We must now embrace a multilateral position on an expansive scale.<sup>58</sup> The prosperity of the United States depends on the prosperity of the rest of the world; by insulating the Western Hemisphere from international trade, the United States would contribute to a depression. Only with fair trade policies can the United States prevent the economic disasters of the past from reoccurring. Policies like a

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<sup>56</sup> Ibid., 207.

<sup>57</sup> O'Sullivan and Gutenberg, *Sumner Welles, Postwar Planning, and the Quest for a New World Order, 1937-1943*, 28.

<sup>58</sup> Welles, *The Time for Decision*, 403.

strict application of the Monroe Doctrine and the Ottawa agreements were obstacles to world prosperity.<sup>59</sup> Welles' aggressive interpretation of policy, especially toward Germany, was what distinguished him from Hull. Hull became increasingly uneasy with Welles proactive approach to the looming German threat in Europe causing a split at the State Department.

Welles believed the Germans had a false impression of the Monroe Doctrine and were using that to advance their own foreign policy position. Welles maintained that the Monroe Doctrine has never in reality been anything more than a unilateral declaration by the United States that it would not permit any non-American power to interfere in the political relations of the Western Hemisphere. It neither implied what the Germans claimed—the exclusion by the United States of non-Americans' powers from having any trade relations with other American Republics—nor did it imply that the United States had political power over its southern neighbors.<sup>60</sup> American policy should make it clear that even though political interference was not welcome free trade relations were.

Welles was also a strong advocate of improved relations with the Soviet Union. He felt that many US officials had an “insane delusion” that communism and democracy could not coexist. From a historical and a geopolitical perspective, Welles argued that the United States and Russia were natural allies, and for the first time in its history, the current Soviet government was guided by the popular will of its people.<sup>61</sup> There were no traditional or material grounds for antagonism between the people of Russia and the people of the United States. In recent years, the Soviet government has discarded many of

<sup>59</sup> Ibid., 409.

<sup>60</sup> United States Department of State, “Foreign Relations of the United States Diplomatic Papers, 1940. General,” 1940, 40, <http://digicoll.library.wisc.edu/cgi-bin/FRUS/FRUS>.

<sup>61</sup> Sumner Welles, *Where Are We Heading?* (New York, London: Harper & Brothers, 1946), 1.

its most radical programs. From the Russian Revolution until WWII, the diplomatic relationship between the US and the USSR has been troubled.<sup>62</sup> In the postwar world, the United States should develop solid relations with the USSR. The fact that the United States is a Western power makes it natural for Russia to be suspicious, but better diplomatic relations will be beneficial for both nations.<sup>63</sup> Welles' positive attitude of the Soviets affected his policy recommendations on Germany. Welles saw Germany as a rogue nation in which its European interests did not align with those of the United States.

### Early Perspectives on German Partition

One of the most daunting concerns for postwar planners was how to finally curb Germany's expansionist ambitions. The debate centered on whether to partition the country. Welles, a regionalist, was in favor of German dismemberment. Bowman, Pasvolsky, and Hull were against German dismemberment.<sup>64</sup> How a State Department official lined up on German partition depended on two points. Those who looked to a postwar world based on multilateralism rather than territorial concerns tended to favor a unified Germany, whereas those who looked to regional spheres of influence based on borders were more likely to favor a partition of Germany. A second factor depended on a person's views of the Soviet Union. Those with positive attitudes toward the Soviets tended to favor a divided Germany. Leaders concerned about Soviet aggression in Europe were in favor of a united Germany.

Welles and the ACPFP planners began the process of planning postwar policy by assuming a complete defeat and unconditional surrender. Welles had strong views on

<sup>62</sup> Welles, *The Time for Decision*, 309.

<sup>63</sup> *Ibid.*, 327.

<sup>64</sup> Penrose, *Economic Planning for the Peace*, 226.

German reconstruction. He felt that a dismembered, non-expansionist, and reconstructed Germany could be an integral part of an integrated Europe; the new Germany should be decentralized and returned to its “pre-Bismarckian period.” A unified Germany would be too strong and would not be able to promote European postwar stability.<sup>65</sup> In contrast, Bowman claimed that in the long term, Russia would constitute a greater threat than Germany. If the United States divides Germany, it may be forced in ten years to ask Germany to reunite for the purpose of holding Russia in place.<sup>66</sup> Bowman also felt that the United States had no choice but to occupy postwar Germany and assume a greater responsibility for European affairs.

The central argument for the planners in 1942 focused on whether Germany or the Soviet Union was going to constitute a future threat. From the start, ACPFP members drew sides with either Welles, who held a deep-seated antagonism for Germany, or with Bowman, whose greatest concern was an aggressive Soviet Union. Bowman alleged that a strong united Germany was needed as a counterpoise to the Soviet Union. Welles felt that Germany’s power should be weakened by dividing the nation into a confederation of autonomous republics held together only by a *Zollverein*, or customs union.<sup>67</sup> Welles saw his plan as a compromise; German districts would be large enough to support themselves but not so large as to be a threat. He believed that dismemberment would eliminate Germany’s two major internal threats: the Junker class and the German General Staff.

The consensus of US planners changed over time. In 1941, when German troops were driving into Russia, it seemed imperative that the breaking up the German nation

<sup>65</sup> O’Sullivan and Gutenberg-e (Program), *Sumner Welles, Postwar Planning, and the Quest for a New World Order, 1937-1943*, 109.

<sup>66</sup> Smith, *American Empire*, 333.

<sup>67</sup> *Ibid.*, 332.

was the only solution. By 1943, with Soviet troops pushing back the Nazis, concern over Soviet domination of Europe was taking hold.<sup>68</sup> As Allied troops advanced across the western front, many on the State Department planning committee started to change their mind in favor of a united Germany. In addition to concerns about Soviet expansion, many State Department planners felt that a divided Germany would be more difficult to integrate into an American-led global economic system.<sup>69</sup> As the end of the war approached, the State Department focused on developing policy recommendations based on how the German economy would fit into a postwar Europe and not on geopolitical concerns.

Bowman and Welles may have been fighting for the same postwar US international concept of a grand area, but their views differed sharply as to Germany's proper position in Europe.<sup>70</sup> Welles' deep-seated antagonism for what he believed was a German tendency toward authoritarianism. He rejected what he felt was Berlin's nationalist centralized authority over a widely divergent group of German peoples. In contrast, Bowman was motivated by economics and his anxiety over the Soviet Union. All that was needed to prevent a resurgent German nationalism was disarmament. Peace and prosperity could be achieved without economic and political dismemberment.<sup>71</sup> Bowman believed that the centrality of German industrial capability was critical to the future of European prosperity and necessary to impede Soviet influence.

Welles' views on partition stemmed from his belief that the root problem was the centralization of German power in Berlin. This process had created the ability for the

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<sup>68</sup> Ibid.

<sup>69</sup> O'Sullivan and Gutenberg-e (Program), *Sumner Welles, Postwar Planning, and the Quest for a New World Order, 1937-1943*, 113.

<sup>70</sup> Smith, *American Empire*, 335.

<sup>71</sup> Ibid., 334.

Germans to become a menace. Individual Germanic states by themselves are not a threat; therefore, the solution is to weaken Germany by partition. Welles claimed that there was no valid reason why the German economy would be ruined by partition.<sup>72</sup> The three German states proposed by Welles (see maps below) would have a balanced economy with portions of industrial, agricultural, and mineral resources.

Welles' position most likely came from his views on both German history and the tendencies of the German people. For Welles, history has shown that Germany had never made any constructive contribution to world peace or regional peace. He acknowledged German contributions to civilization but believed that the problem originated with the willingness of the German people to fight for the German General Staff. Welles argued that Germany may undergo defeat in WWII, but the German General Staff is a living force that will re-inspire the German people to threaten the future peace of Europe.<sup>73</sup> The Nazi national psychology cannot be modified solely by a change in governmental structure. Democracy must come from the people themselves; the current German youth are poisoned and it might take some time before democracy can be established.<sup>74</sup> Therefore, Welles believed that his nuance position would provide European security by dividing Germany, but also that a series of Germanic states would be viable enough to contribute to the economic recovery of Europe.

### Department Rivals Push Back

In August 1944, a storm was brewing over the postwar treatment of Germany and about to challenge the direction of State Department postwar planning. Both the Treasury

<sup>72</sup> Welles, *The Time for Decision*, 349.

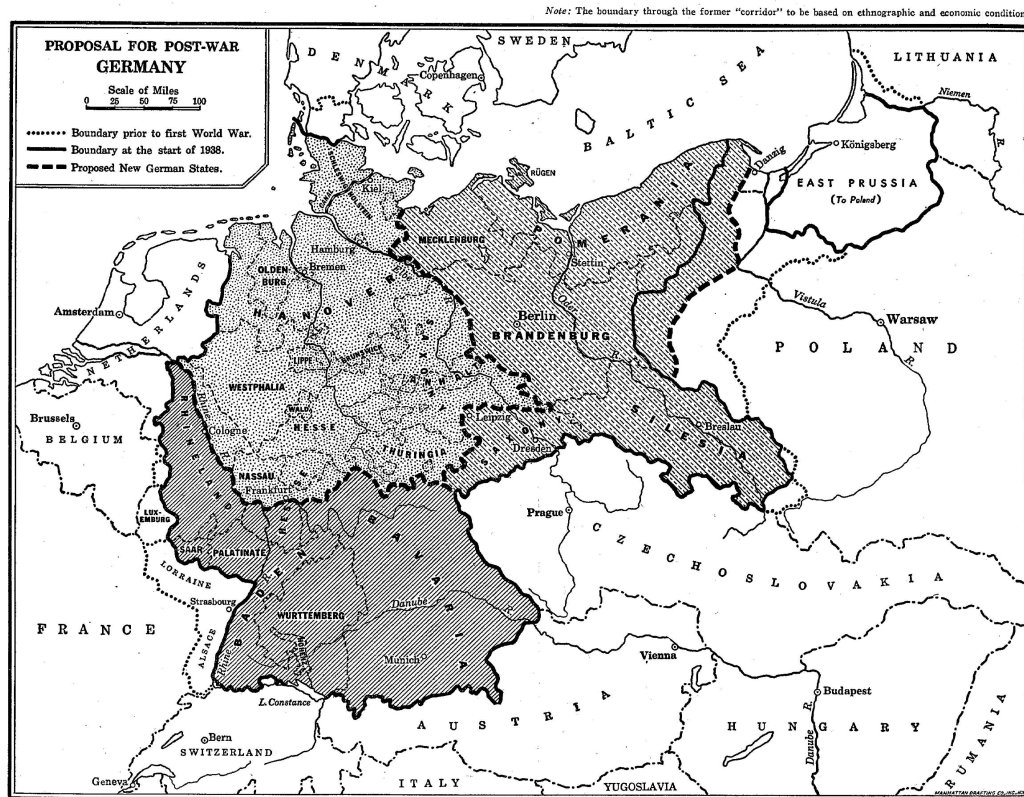
<sup>73</sup> *Ibid.*, 340.

<sup>74</sup> *Ibid.*, 361.



Department and Roosevelt had distinctly different views on Germany and were about to start an intergovernmental conflict that would have long-term ramifications. The State Department had been working on planning since 1939 and had reached somewhat of consensus with both the War Department and the British for the promotion of the German economy. By 1944 officials from various branches of the government were starting to draw up maps for postwar Germany, and it is from these maps that we can get a sense of the state of the debate in 1944 concerning the direction of postwar policy.

All three of the following maps are dated from 1944. Each map highlights the motivating forces behind the official who created them. The Sumner Welles map for the proposed division of Germany was rooted in State Department policy in which multilateral economic prosperity was a key concern. It was a carefully designed proposal by which Germany was divided in an attempt to maintain the economic viability of each German State, while satisfying Welles' distrust of a large central German state. Welles' desire to partition Germany sets him apart from most other State Department planners. His motivation was to seek a middle ground and break up German military and political power while still allowing for all the German industrial regions to contribute to European prosperity.

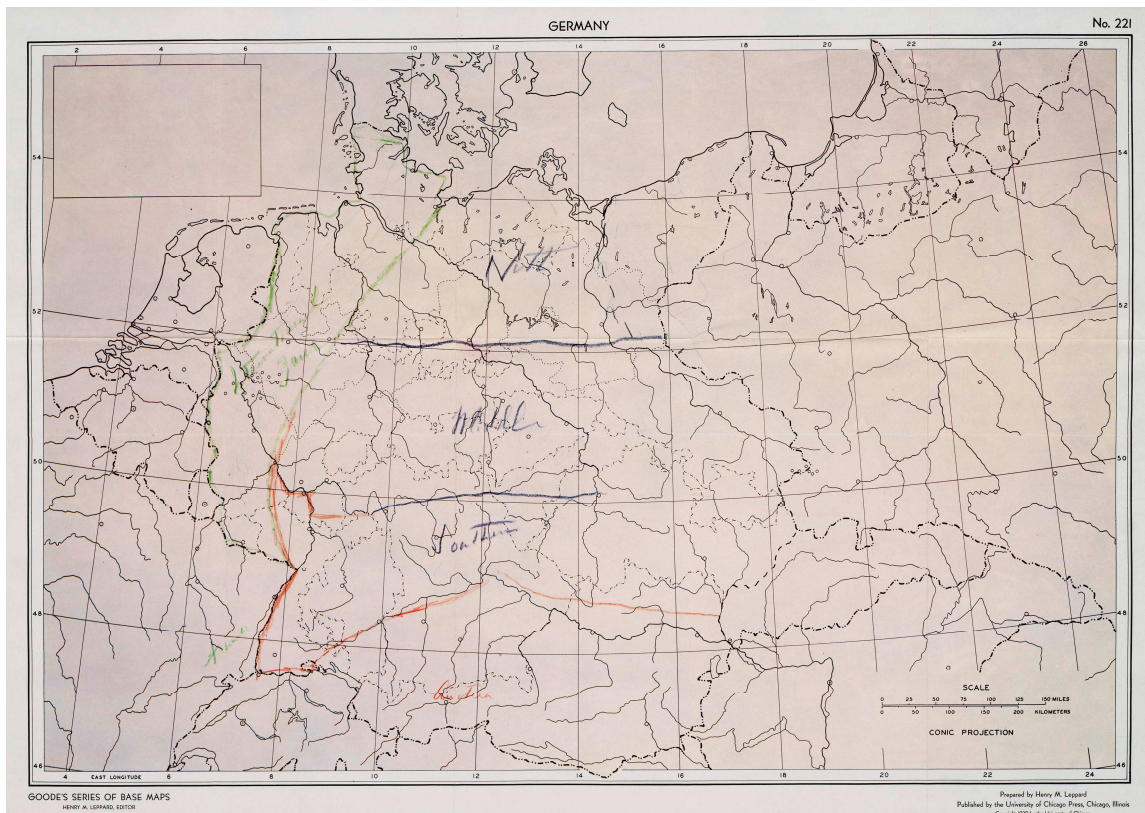


Summer Welles Map 1944<sup>75</sup>

In contrast, the Roosevelt map reveals a different perspective on how to approach the partition of Germany. The president's delineations were made on a map of physical geography void of any solid political boundaries, as if all the boundaries of Central European nations were wide open for modification. Roosevelt's zones dividing Northern, Central, and Southern Germany were drawn in a haphazard manner, possibly an expression of his desire to put off final plans for the partition of Germany until the

<sup>75</sup> Ibid., 342.

occupation started. It is clear from this map that in 1944, Roosevelt had made no careful consideration for the economic welfare of these future German states.



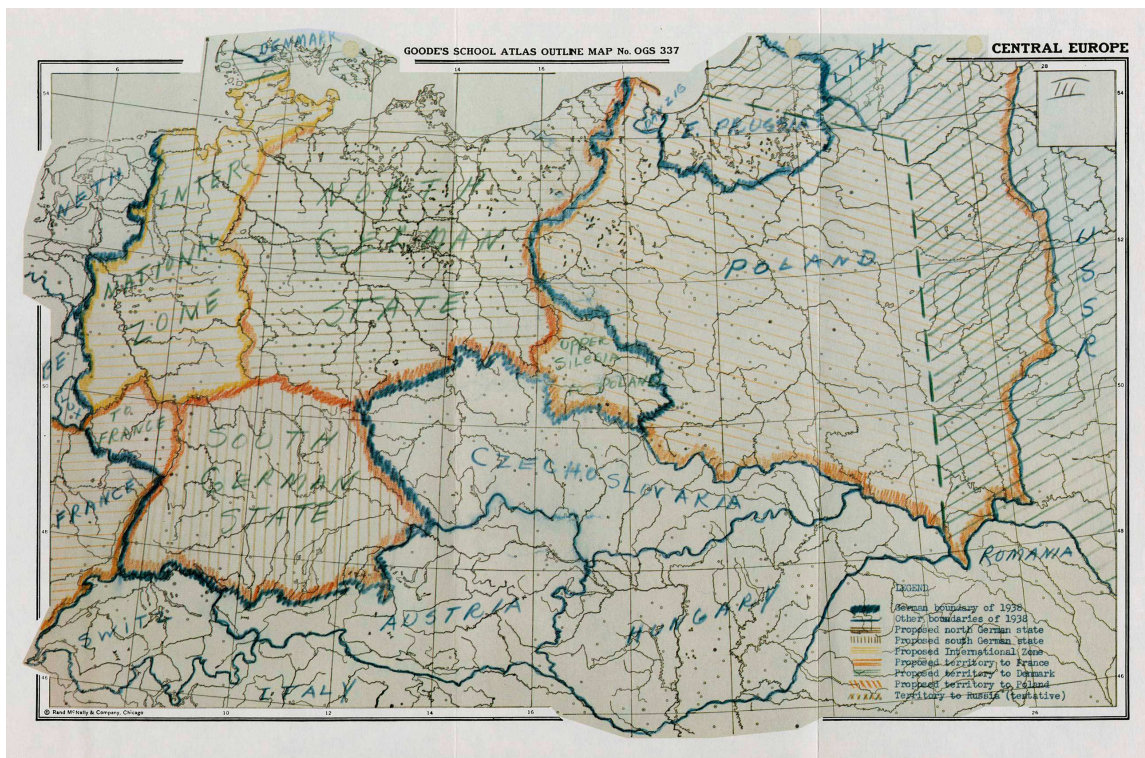
FDR Map<sup>76</sup>

Finally, the Morgenthau map shows no concern for the economic maintenance of a German state. Major tracts of highly productive regions would have been given away. Poland would get Upper Silesia, France would get the Saarland, and all of Rhine and Saxony areas would be put under international control. Many of Germany's major ports would be lost and much of the nation would be landlocked, cut off from international

<sup>76</sup> United States Department of State, "Foreign Relations of the United States. Conference at Quebec, 1944," 1944, 392, <http://digicoll.library.wisc.edu/cgi-bin/FRUS/FRUS>.



commerce. It seems clear that the objective of Morgenthau's proposal was to cripple Germany.



Treasury Department Map<sup>77</sup>

<sup>77</sup> Ibid., 86.

## Chapter III

### 1944–1945: Interdepartmental Struggle

#### The Treasury Department Offensive—August 1944

August 1944 was the starting point for a crisis in the postwar planning process. The Secretary of the Treasury Henry Morgenthau, Jr., with an unwelcome provocation, tried to change the direction of postwar planning that was already well underway at the State and War Departments.<sup>1</sup> The disturbance by Morgenthau was unexpected, like a sudden storm catching the State and War Departments by surprise. Secretary of War Henry L. Stimson, agreeing with Hull over the egregious nature of the interference, referred to this incident as the most contentious interdepartmental struggle of his thirty-five year cabinet-level career.<sup>2</sup> Morgenthau's intrusion into the planning for the occupation of Germany went far beyond the legitimate agenda of the Treasury Department. By the summer of 1944, both the State and War Departments had been making like-minded contributions to a policy plan that would lead to a constructive peace for Germany and Europe as a whole. In a single purposeful stroke, Morgenthau forced American policy toward Germany to take a dramatic turn that would cause detrimental ramifications for Germany and Europe during the first three years of the postwar period.

This was not the first time that Morgenthau had interfered. Hull had grown resentful of the Treasury Secretary from his earliest days in government. Hull alleged that Morgenthau seldom lost an opportunity to step into State Department jurisdiction and

<sup>1</sup> Penrose, *Economic Planning for the Peace*, 250.

<sup>2</sup> Henry Lewis Stimson, *On Active Service in Peace and War*, 1st ed. (New York: Harper, 1948), 566.

obstruct policy. Often times he was found to be conducting negotiations with foreign governments on his own.<sup>3</sup> Hull believed that Morgenthau was driven by emotion and frequently sought to use his close relationship with the president to induce actions that were contrary to the State Department's better judgment. Hull considered Morgenthau's interference in postwar planning for the occupation of Germany as his worst offence.<sup>4</sup>

After August 1944, any chance of a studied rational approach to postwar policy in Washington was over. The policy consensus created by the planners at the State Department, War Department, and CFR would have to be put aside. This dispute became a long and bitter quarrel between cabinet-level departments in which the near term fate of Germany hung in the balance.<sup>5</sup> A victory for Morgenthau would mean economic misery for Europe and the German people. A victory for the State Department would mean a faster recovery for Europe and a lessened burden on US occupation forces.

The interference started in August 1944, upon Morgenthau's return from a trip to Europe, when he informed Roosevelt about what he considered the proposed liberal treatment of Postwar Germany by the State and War Departments. He was referring to numerous State Department planning memoranda and the War Department's occupational handbook. The Supreme Headquarters Allied Expeditionary Force (SHAEF) Handbook was to provide the US Military with instructions for the occupation. Morgenthau, a close personal friend and long-time aide to the president had enough access and influence to press Roosevelt into taking action.<sup>6</sup> Both Roosevelt and Morgenthau were in favor of harsh treatment for Germany and both considered State and

<sup>3</sup> Penrose, *Economic Planning for the Peace*, 243.

<sup>4</sup> Cordell Hull, *The Memoirs of Cordell Hull* (New York: Macmillan Co, 1948), 207.

<sup>5</sup> Kuklick, *American Policy and the Division of Germany; the Clash with Russia over Reparations.*, 51.

<sup>6</sup> Penrose, *Economic Planning for the Peace*, 250.

War Department plans too sympathetic to Germany.<sup>7</sup> On August 26, 1944, Roosevelt sent a memorandum to Hull and Stimson criticizing both the SHAEF Handbook and the State's proposed lenient treatment of Germany. The president expected them to reassess their positions on the treatment of postwar Germany.

In early September of 1944, because of his dissatisfaction with the postwar policy and discontent among his Cabinet members, Roosevelt called for the creation of an informal "Cabinet Committee on Germany" to resolve policy disagreements dealing with the occupation. The committee was to consist of Hull, Stimson, Morgenthau, and the Secretary of Commerce Harry Hopkins.<sup>8</sup> The committee meetings were the beginning of a contentious debate between Hull and Stimson who favored rebuilding Germany and Morgenthau who wanted to deindustrialize Germany. The committee held only a few meetings that resulted in no resolution to the conflict. Roosevelt had no intention of using this committee to set policy, the purpose of the meeting was to resolve the turmoil within his cabinet. As was so often the case with the president, policy would be set by him, at his discretion.

On September 12, 1944 at the Second Quebec Conference held with British Prime Minister Churchill, Roosevelt reinforced his support for Morgenthau's plan. The agenda of the conference was intended to be a discussion of Allied military objectives, but matters turned to address Lend-Lease aid for Britain and the postwar treatment of Germany. With Hull and other State Department officials not in attendance the president had a free hand to institute postwar policy. Churchill was determined to secure additional

<sup>7</sup> Kuklick, *American Policy and the Division of Germany; the Clash with Russia over Reparations.*, 53.

<sup>8</sup> Harley A. Notter, United States, and Department of State., *Postwar Foreign Policy Preparation, 1939-1945.*, Department of State Publication ; 3580. General Foreign Policy Series ; (Washington, U.S. Govt. Print. Off., 1949), 369.

Lend-Lease aid for Britain, while Roosevelt called on Morgenthau to convince the British to accept Morgenthau's plan for punitive treatment of Germany.<sup>9</sup> In the end, a quid-pro-quo agreement was reached in which Roosevelt and Morgenthau gained Churchill's agreement for a harsh treatment of Germany; in exchange, they agreed to give Britain additional Lend-Lease aid.<sup>10</sup> It was clear from the negotiations that both the Treasury Secretary and the president would be forceful in their desire to ensure that the postwar period in Germany would be a difficult one.

Morgenthau's actions in August and September of 1944 dismayed Hull; the Treasury Department's intrusion into postwar planning was a repudiation of the State Department's central doctrine of multilateralism. By advocating for economic misery in Germany, Morgenthau was putting the postwar prosperity of Europe and the world at risk.<sup>11</sup> The difficulties between the State and Treasury Departments had implications far beyond the German occupation. Treasury officials were looking toward a measured future of monetary regulation and securitized international lending, similar to those recently formulated at the Bretton Woods Conference; it seemed that that they were limiting postwar policy to repairing the problems of the interwar period. Officials at State had a more grandiose policy plan; they were optimistically looking to the future with its vision of an expansive commercial network delivering prosperity to all.

The president and his Cabinet Departments all had competing ideas on ways to address global economic issues at the end of the war. Roosevelt saw the promotion of postwar global prosperity by the exportation of US New Deal-type programs in which he

<sup>9</sup> John Dietrich, *The Morgenthau Plan Soviet Influence on American Postwar Policy* (New York: Algora Pub., 2002), 53.

<sup>10</sup> Kuklick, *American Policy and the Division of Germany; the Clash with Russia over Reparations.*, 54.

<sup>11</sup> *Ibid.*, 52.



would be free to pick winners and losers among nations. Morgenthau and his closest advisor at the Treasury Department, Dexter White, were striving for global financial security by the use of monetary regulation and the securitization of international lending. Hull and postwar planners at the State Department promoted a wide-open style of prosperity in which every nation could participate through the reduction of trade barriers and the elimination of quotas and cartels. Stimson at the War Department believed in an economic policy that aligned closely with Hull's, but Stimson's overriding concern was that the US military occupation forces in Germany should have a free hand and not be restricted by any departmental economic doctrine. These competing postwar ideologies created a conflict that contaminated the first few years of the occupation of Germany.

The first major result of the US conflicted policy was the implementation of the Joint Chiefs of Staff directive JCS1067. This directive was secretly issued in April 1945 just as Allied troops were moving into Germany. Assistant Secretary of War John McCloy played a key role in authoring the directive and working through the interdepartmental struggle to get something on paper. Though he did not solve the interdepartmental disagreement or get unanimous approval, he did advance a document that gave some guidance to the military commanders in charge of the German occupation.<sup>12</sup> Initially, JCS1067 appeared less punitive than Morgenthau's plan, but the overall attitude of the directive implied the economic stagnation of a devastated Germany.<sup>13</sup> The State Department was never in agreement with the text of the directive and insisted to change it as it was being written.

<sup>12</sup> Thomas Alan Schwartz, *America's Germany: John J. McCloy and the Federal Republic of Germany* (Cambridge, Mass.: Harvard University Press, 1991), 21.

<sup>13</sup> Stimson, *On Active Service in Peace and War*, 582.

The struggle to pushback against the Morgenthau Plan was just one example of the effort made by the State Department to change the long-term direction of US foreign policy. Throughout the 1940s, they never gave up on their commitment to a multilateral approach, even in the face of a direct challenge from the executive and cabinet-level branches of government.<sup>14</sup> The policy positions worked out by the early planners under the direction of Hull and Pasvolsky may have been refined and restated by the State Department at various points during this period, but the essence of their position was never abandoned.

#### Treasury Department's Position

Introduction of the Morgenthau Plan grew out of the Treasury Secretary's deep disgust for German conduct toward the Jews, being of Jewish descent he was morally outraged at Nazi racism. He and Roosevelt rejected the distinction made by the State Department between the German people and the Nazis. All Germans deserved harsh treatment, a type of forced rural resettlement program and a soup-kitchen standard of living.<sup>15</sup> The Morgenthau Plan called for the dismantling of German heavy industrial capabilities on a massive scale. The United States should not allow Germany to rebuild itself and must limit its economy to agriculture and light industry. Germany would be partitioned, large parts of it given away to its neighbors, and the Ruhr should be internationalized. The country would be occupied and economic poverty would be enforced. There would be no economic recovery in which to pay reparations. All capital equipment would be disassembled and given out as remuneration.

<sup>14</sup> Kuklick, *American Policy and the Division of Germany; the Clash with Russia over Reparations.*, 20.

<sup>15</sup> Warren F. Kimball, *Swords or Ploughshares?: The Morgenthau Plan for Defeated Nazi Germany, 1943-1946*, The America's Alternatives Series (Philadelphia: Lippincott, 1976), 25.

A debate among historians has surfaced as to who was responsible for the Morgenthau Plan. The inquiry centered on White who played a crucial role in the formation of the Morgenthau Plan. It seems true that White was both a Communist sympathizer and a Soviet agent.<sup>16</sup> However, the argument that White skillfully maneuvered Morgenthau into developing the plan at the command of the Soviets does not seem valid. Looking closely at postwar goals for the Soviet Union, if White was acting at the direction of the Soviets, the Morgenthau Plan would have more carefully followed Soviet goals. He would have allowed for a German capability to pay larger reparations and advocated for a united Germany in anticipation of eventual Soviet domination.<sup>17</sup> It seems more likely that White's contribution to the Morgenthau Plan was in direct accordance with the wishes of both Morgenthau and Roosevelt, not those of Stalin.

Although it appears that White was not the instigator of the Morgenthau Plan, it was clear to State Department officials that the resourcefulness of White in mastering the main points of interdepartmental meetings and reports transformed Morgenthau's vague knowledge and passions into a clear, well-organized statement of the Treasury's position.<sup>18</sup> He had previously attended interdepartmental meetings that addressed German policy, but postwar planning was not his responsibility. In July 1944, White had just concluded his work at the Bretton Woods Conference in which he and the Treasury Department had hosted. With all of the effort required to organize the Bretton Woods Conference, it was difficult to see how he would have been in a position to generate the Morgenthau Plan. However, his opinion on Germany coincided with the majority view of the Treasury Department and he had a full staff of Treasury officials available to help

<sup>16</sup> Dietrich, *The Morgenthau Plan Soviet Influence on American Postwar Policy*, 18.

<sup>17</sup> *Ibid.*, 19.

<sup>18</sup> Penrose, *Economic Planning for the Peace*, 246.

assemble policy plans.<sup>19</sup> When a liberal policy toward Germany was in the works at both the State and War Departments in August 1944, White was qualified and willing to amplify the Treasury Department's punitive policy for which Morgenthau would fight.

The differences of opinion on postwar economic matters between State and Treasury were not confined to the treatment of Germany. The two departments had a fundamental disagreement on how to rebuild the world economic system. The argument made by the Treasury Department was that full free trade would not promote general prosperity.<sup>20</sup> White and the Treasury Department believed that exchange rate stabilization and the promotion of international investment were more practical methods of solving the world's economic problems. As White stated in 1942, "The theoretical basis for the belief still so widely held, that interference with trade and with capital and gold movements, etc., are harmful, are hangovers from a nineteenth century creed, which held that international economic adjustments, if left alone, would work themselves out toward an 'equilibrium' with a minimum of harm to world trade and prosperity. It is doubtful whether that belief was ever sound."<sup>21</sup> The type of policy advocated by the Treasury Department would produce a narrower range of growth in international economic activity than that of State Department. Even if it threatened a percentage of overall European output, the Treasury Department was still willing to destroy German industrial production.

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<sup>19</sup> Vladimir Petrov, *Money and Conquest; Allied Occupation Currencies in World War II.*, The Johns Hopkins University Studies in Historical and Political Science, Ser. 84, No. 2; (Baltimore, Johns Hopkins Press, 1967), 152.

<sup>20</sup> G. John Ikenberry, "A World Economy Restored: Expert Consensus and the Anglo-American Postwar Settlement," *International Organization* 46, no. 1 (Winter 1992): 298.

<sup>21</sup> *Ibid.*

In a head to head competition for the implementation of foreign policy during the Roosevelt presidency the Treasury had an advantage over State. Morgenthau was a long time confidant of the president and had always been willing to do Roosevelt's bidding. By 1944, the Treasury Department had successfully challenged the ambitions of State Department planners and shifted the focus from free trade issues to monetary regulation and capital investment funds.<sup>22</sup> The Bretton Woods Agreement sponsored by the Treasury, was under-funded and completed nine months before the end of the war. The agreement actually undercut State Department strategy, because of the relatively small amounts committed by its participating nations, international commerce was relegated to a relatively low level.

In September 1944, it appeared as if the State Department did not have the political power to realize their postwar dream. As long as a close relationship existed between the president and Morgenthau, it would be difficult for Hull to change Roosevelt's mind or challenge the Treasury Department's initiative. The Treasury Department used a wide range of arguments to support its policy position. One of their main arguments addressed the reparations issue. The Treasury Department was against Germany making reparation payments. If Germany were expected to pay recurring reparations in the form of goods produced, then the German industrial economy would have to be rehabilitated.<sup>23</sup> Both the State and Treasury Departments recognized that a long-term reparation program making payments from goods produced would require a reconstructed Germany; this was a notion to which the Treasury Department was vehemently opposed.

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<sup>22</sup> Ibid., 291.

<sup>23</sup> United States Department of State, "Foreign Relations of the United States. Conference at Quebec, 1944," 1944, 131, <http://digicoll.library.wisc.edu/cgi-bin/FRUS/FRUS>.

The Treasury Department asserted that it was a fallacy to think that Europe needed a strong industrial Germany. Morgenthau pointed out that the United States, Great Britain, France, and the Benelux could supply enough coal for Europe's needs. The elimination of competition from Ruhr industry would be of great benefit to the British and other economies. In summary, the Treasury Department argued that Britain would recover faster without German competition.<sup>24</sup> This was Morgenthau's main selling point to Roosevelt. A chief concern for the president after the war and the recovery of the British economy, the argument that the eliminating German competition would be of great benefit to the British was convincing.

Morgenthau's based his position on the principle that economic prosperity in Germany would lead to future aggression. The Treasury Department maintained that modern German militarism had its basis in the Ruhr. This region rich in coal had been the foundation of an industrial apparatus that was deliberately guided by military objectives. The elimination of a prosperous Ruhr industrial apparatus would make future German aggression impossible.<sup>25</sup> This principle was a direct contradiction to the main premise upon which the State Department's developed its policy plan. The State Department starting planning in 1939 with the conviction that Germany's future economic prosperity would lead to peace. Early postwar planners had based policy development on the supposition that it was economic deprivation that led to the start of WWII.

Morgenthau's Plan specified that no relief should be supplied to Germany other than what was needed to prevent disorder. The Treasury Department recommended that the responsibility for sustaining the German people rested with the Germans and not with

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<sup>24</sup> Ibid., 135.

<sup>25</sup> Ibid.

the Allied occupation forces. Allied Military Governments should not assume responsibility for price controls, rationing, unemployment, reconstruction, housing, or transportation. No relief supplies should be imported beyond the minimum to prevent disease and disorder.<sup>26</sup> With so many punitive measures included that would cause postwar Germans continued misery it seems to be evident that Morgenthau's motives were based on retaliation.

By January 1945, there had been no resolution or agreement among the Cabinet Secretaries over the German issue. By this time, the battlefield front lines in Europe were changing rapidly as both Soviet and Western forces were advancing across Europe. As the positions of the armies changed, so did the points of contention. In a January 1945 memorandum, Morgenthau expressed a new list of concerns to the president. It was important that German heavy industrial capabilities be completely destroyed, not just its weapons industry. The Germans were versatile just like the Americans. US industry was converted from a great peacetime industry in 1940 to the world's greatest producer of military weapons in 1944. The German people with access to heavy industry could do the same. Anyone who disagreed with this point was simply expressing a fear of Russia and communism. Morgenthau stated, "This twenty-year old argument of a "bulwark against Bolshevism" is one factor of what brought this war down on us."<sup>27</sup> By this statement Morgenthau was responding to a new argument being advanced by the likes of Bowman and others at the State Department who were attracting converts to the anti-Soviet camp over concerns that Soviet armies might overwhelm Europe.

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<sup>26</sup> Ibid., 137.

<sup>27</sup> United States Department of State, "Foreign Relations of the United States : Diplomatic Papers, 1945. European Advisory Commission, Austria, Germany," 1945, 377, <http://digicoll.library.wisc.edu/cgi-bin/FRUS/FRUS>.

It was apparent through the spring of 1945 that the Morgenthau-Roosevelt coalition for harsh treatment of Germany was in firm control. Challenges from the State and War Departments had been rebuffed. Despite small changes made to the wording, the directive being written during at this time still ended up with a strong anti-German attitude.

### War Department's Position

During WWII, the influence of the military in Washington was imposing, to the extent that major aspects of US foreign policy became dominated by the War Department. In most matters, the War Department had the ability to veto any proposal formulated at the State Department.<sup>28</sup> McCloy pointed out that the State Department had been working on a policy for postwar Germany for years; however, because of the preoccupation with winning the war, State Department planners were not linked to the War Department's policy. After Pearl Harbor, the State Department had neither the budget nor the political power to rival the influence of the military.<sup>29</sup> Even though the War Department had the power and position to challenge any postwar policy formulated by State Department planners, the State and War Departments were in agreement on many of the main ideals for the postwar German economy. But an even more important factor was the exemplary reputation of Stimson and his relationship with Hull. This meant that the War Department and its distinguished Secretary Stimson constituted a significant ally for the State Department in its struggle over the postwar treatment of Germany.

<sup>28</sup> Penrose, *Economic Planning for the Peace*, 233.

<sup>29</sup> John Jay McCloy, *The Challenge to American Foreign Policy*, The Godkin Lectures at Harvard University 1953 (Cambridge: Harvard University Press, 1953), 50.



Despite the similarity between Stimson and Hull on policy, they came to their respective positions based on different motivations. Unlike Hull, Stimson was an Anglophile who believed postwar policy should center on the same concept as the concept the United States followed during the war—the fundamental unity of Anglo-American interests.<sup>30</sup> However, they both agreed with the central notion that the United States should become more involved in world affairs and that a future of peace would be based on global economic prosperity. Stimson stated, “Germany would have to be punished and its leadership changed, but also, Germany would have to be rebuilt and restored to the center of Europe’s economy.”<sup>31</sup> He categorically opposed a punitive settlement that would leave Germany in a state of postwar chaos. This point was critical for the War Department officials because they were going to be in charge of the occupation, one that would be long and difficult in a chaotic situation.

By 1944, it appeared that the US Army was going to outrun the policymakers. Stimson remarked to the president in August 1944, “We were running into a lack of preparedness. Our troops were going into Germany and they had no instructions.”<sup>32</sup> Even though SHAEF had been developed as a military occupation plan with little guidance from Washington, the policy laid out in the SHAEF Handbook was in harmony with the views of both Stimson and the State Department planners. By September 1944, Stimson had approved the recently completed handbook.<sup>33</sup> It was this handbook and the

<sup>30</sup> Stimson, *On Active Service in Peace and War*, 566.

<sup>31</sup> David F. Schmitz, *Henry L. Stimson: The First Wise Man*, Biographies in American Foreign Policy, no. 5 (Wilmington, Del: SR Books, 2001), 165.

<sup>32</sup> Stimson, *On Active Service in Peace and War*, 569.

<sup>33</sup> Richard Nelson Current, *Secretary Stimson, a Study in Statecraft* (New Brunswick: Rutgers University Press, 1954), 217.

supporting memoranda from the State Department that Morgenthau and White had reacted to vehemently in August 1944.

The overriding interest of the War Department during the occupation was its ability to be in complete control. Stimson and McCloy were resolute in their insistence that the officers in charge of Germany not be tied down to any policy principles. The assumption of responsibility for the occupation must be undivided and controlled by the military. It was felt that the occupation would be a test of the ability for the United States and the Soviets to cooperate. The desire for complete control was felt so strongly that the US military believed any combination of US and British occupation forces would not be advisable because it would severely limit the freedom of American policy in Europe.<sup>34</sup> It was expected that the creation of separate zones for the British and US forces was a necessity so that the US military could have a free hand in mediation with the Soviets.

Stimson had other reasons to support a constructive treatment; he felt that fair treatment of Germany would signal to the world that the United States would build a prosperous, peaceful world.<sup>35</sup> Stimson was a member of a Cabinet that was deeply divided on occupation policy. Stimson believed that Germany would have to be the dominant economy for Europe to recover. Hull advocated for a viable but not dominate Germany. Morgenthau wanted the Germany industrial base smashed. Stimson found himself in strong opposition to Morgenthau. In his memorandum to the president on September 5, 1944, Stimson expressed his concerns over three points of Treasury's economic policy and how bad its implementation would appear to the rest of the world: (1) that the standard of living be held down to subsistence levels; (2) that the German

<sup>34</sup> Penrose, *Economic Planning for the Peace*, 234.

<sup>35</sup> Schmitz, *Henry L. Stimson*, 166.

economic position of power in Europe must be eliminated; and (3) that the German economy must be converted so as to be dependent upon imports and exports.<sup>36</sup> The War department was directly responsible for the outcome of the German occupation and he did not want a repeat of the Treaty at Versailles and its economically senseless demands. The speed of reconstruction was of great importance if the United States hoped to avoid great convulsions in Europe. Punitive methods would not prevent war; they would breed war.<sup>37</sup> Stimson recommended that Treasury policy be discarded; perhaps the Ruhr's economic resources could be put under international control, but not destroyed.<sup>38</sup> For Stimson, if Europe were to recover, Germany would have to be the center of the European economy.

By September 1944, to defend their position, both Stimson and Hull had to challenge the president on his postwar plan. As a rebuff to Roosevelt's agreement at the Second Quebec Conference, Stimson sent a memorandum reiterating his point, "Sound thinking teaches that prosperity in one part of the world helps to create prosperity in others. The only question now is whether seventy million educated, efficient, and imaginative German's can be kept within the bounds on such a low level of subsistence."<sup>39</sup> Stimson reminded the president that he had declared in the Atlantic Charter that victors and vanquished alike were entitled to freedom from economic want. The harsh suppression of Germany for the benefit of other nations would go against what Hull had been trying to accomplish since 1933.<sup>40</sup> However, a policy directive for the

<sup>36</sup> State, "Foreign Relations of the United States. Conference at Quebec, 1944," 99.

<sup>37</sup> Ibid.

<sup>38</sup> John L. Chase, "The Development of the Morgenthau Plan Through the Quebec Conference," *The Journal of Politics* 16, no. 2 (May 1, 1954): 344, doi:10.2307/2126031.

<sup>39</sup> State, "Foreign Relations of the United States. Conference at Quebec, 1944," 482.

<sup>40</sup> Ibid.

military had to be written; the challenge for the War Department over the winter of 1944–1945 was to write a directive that would get the approvals of the president and Morgenthau but give enough flexibility to the military to be workable in Germany.

The War Department's influence over the creation of JCS1067 fell on McCloy. He realized how difficult it would be for the military to implement the Morgenthau Plan in postwar Germany, so in response, he worded the directive to win the approval of the Treasury but still give military commanders maximum flexibility. The directive was in the works for most of the winter and was signed by President Truman in May 1945.<sup>41</sup> McCloy ensured that certain phrasing was included within the text to allow the occupation forces enough interruptive leeway to respond to the situation on the ground.

#### State Department's Position

By August 1944, State Department policy planners were the only department to have spent the last five years making a persistent effort to assemble a post-war policy. Planners considered their work to be based on reason and held a conviction that their intentions for the postwar world were good. The proposed postwar policy advocated by the State Department was based on a set of rational assumptions with which neither Morgenthau nor the Treasury could agree.

In matters concerning the postwar economy, Hull was neither pro-Germany nor anti-Germany. He and his department were in favor of a Germany that was integrated into a European world economy on the basis that this would be a requirement to achieve long-term peace and prosperity. Rebuilding a strong Germany was not Hull's aspiration;

<sup>41</sup> Notter, United States, and Department of State., *Postwar Foreign Policy Preparation, 1939-1945.*, 1949, 370.

it was multilateral economic development that by necessity included Germany. Considering the recent tragedy of Nazi brutality, Hull's position on Germany over the course of the planning period may have seemed detached, but he believed it was time to make a clean cut with his emotional ties to history and to plan a future based on optimism and opportunity.

One early premise for postwar planning was that a united Germany fit into the State Department concept of a multilateral world. Multiple zones of occupation would be detrimental to international commerce. One of the forms of occupation that they had given serious consideration to was an inter-allied occupation.<sup>42</sup> As early as 1942, the State Department was hopeful that an arrangement could be made in which there would a mix of Allied troops throughout all of Germany. Having a truly joint occupation with no national sectors would go a long way toward guaranteeing that the Allies would not divide Germany.<sup>43</sup> The consensus among planners was that the forcible partition of Germany would create a situation based on "spheres of influence" and should be opposed.<sup>44</sup> As late as 1944, they believed that both the British and the Soviets could eventually be persuaded to support a united multilateral Germany.<sup>45</sup> It was not until 1947 that the State Department came to recognize that the division of Germany might become a necessity to at least guarantee that the Western zones of Germany were included in a multilateral Europe.

Another basis for the policy positions taken by State was the belief that the assimilation of the Germany economy into a grand European economy was all that was

<sup>42</sup> Penrose, *Economic Planning for the Peace*, 233.

<sup>43</sup> Kuklick, *American Policy and the Division of Germany; the Clash with Russia over Reparations.*, 35.

<sup>44</sup> State, "Foreign Relations of the United States. Conference at Quebec, 1944," 95.

<sup>45</sup> Kuklick, *American Policy and the Division of Germany; the Clash with Russia over Reparations.*, 41.

necessary to end any future German military threat. In August 1944, Hull upheld his position that partition should not be imposed and that Germany should be assimilated into the world economy without discrimination and dismemberment.<sup>46</sup> The Secretary maintained that the forced conversion of German economic capacity from war to peace production would be sufficient to eliminate any future German military threat. This process would cause a fundamental change in the organization of German economic life and, in return, would pay a large peace dividend.<sup>47</sup> Hull had a deep-seated confidence in the policy recommendations of his department. Despite genuine fears by many about the future security of Europe, Hull was willing to trust that sound international economic policy would be sufficient to eliminate future German militarism.

On September 5, 1944, the first Cabinet Committee meeting was held in which Morgenthau, Stimson, and Hull met to discuss postwar treatment of Germany. At the meeting, it appeared to Stimson as if Hull was in support of Morgenthau's Carthaginian peace. Stimson commented that he (Stimson) was the only one at the meeting in favor of reconstructing Germany. Stimson speculated that Hull had buckled under the pressure of the president and Morgenthau, only to revert back to his longtime policy of a prosperous postwar Germany at a later date.<sup>48</sup> In his memoirs, Hull explained his position in the meeting on September 5, 1944, stressing that at no time did he demonstrate any support for Morgenthau's economic policy in Germany.<sup>49</sup> It is evident that there was a difference between how Hull and Stimson approached a reconstructed Germany; however, there is no support shown by Hull for Morgenthau's Plan. The lengthy evidence in the State

<sup>46</sup> Hull, *The Memoirs of Cordell Hull*, 1948, 1606.

<sup>47</sup> State, "Foreign Relations of the United States. Conference at Quebec, 1944," 95.

<sup>48</sup> Stimson, *On Active Service in Peace and War*, 570.

<sup>49</sup> Hull, *The Memoirs of Cordell Hull*, 1948, 1608.

Department records along with Hull's account of the Cabinet Committee meetings highlights a disagreement between Hull and Stimson, but does not indicate any support by Hull for Morgenthau's plan. All positions taken by Hull at the Cabinet Committee meeting were consistent with long-time State department policy. The Secretary of State opposed German partition, opposed complete deindustrialization, and discredited the idea of an agriculturalized Germany.<sup>50</sup> In the meeting on September 5, 1944, Hull presented and used as a basis for discussion the September 4, 1944 State Department memorandum in which it is stated "The State Department is, in general, opposed to the forcible partition of Germany."<sup>51</sup> In addition, "It is in the long-range interest of the United States the Germany be prosperous but that, at the same time, the German economy should not again be directed to war-like purposes."<sup>52</sup>

In his memoirs, Hull helped to explain what appeared to be contradictory comments, but were in fact consistent with long-term State department policy. Hull stated three objectives for postwar German economic policy. First, "the standard of living of the population should be held down to subsistence levels."<sup>53</sup> This seems punitive, but a distinction can be made by which the reconstruction of a prosperous Germany could entail the temporary enforcement of lower living standards for the purposes of rebuilding commerce and paying reparations. Second, "Germany's economic position of power in Europe must be eliminated."<sup>54</sup> This statement is completely consistent with multilateralism by which no country becomes so dominant in a market that it infringes on every other nation's free access. And third, "German economic capacity must be

<sup>50</sup> Penrose, *Economic Planning for the Peace*, 253.

<sup>51</sup> State, "Foreign Relations of the United States. Conference at Quebec, 1944," 94.

<sup>52</sup> *Ibid.*, 60.

<sup>53</sup> Hull, *The Memoirs of Cordell Hull*, 1948, 1609.

<sup>54</sup> *Ibid.*

converted in such a manner that it would be so dependent on imports and exports that the country could not by its own devices reconvert to war production.”<sup>55</sup> This is also a basic tenant of multilateralism in which peace is guaranteed by the development of an inter-dependent world economy. Without a clear understanding of the State Departments concept of global multilateralism, policy recommendations toward Germany may have appeared to be punitive when they were not.

In September of 1944, Hull and the State Department still held hopes of breaking up the British Imperial system. In many ways, this was of greater concern to the future of multilateralism than a prosperous Germany. Hull wanted a multilateral European continent including an economically viable Germany, but the long-time State Department aim of bringing an end to the Ottawa Agreements was still of the highest priority.<sup>56</sup> To accomplish this goal, Hull would need the support of the president. Hull had hoped that Roosevelt, who in the past had supported Hull’s free trade policy, would use his position of power over the British to convince them to bring an end the Ottawa Agreements.

The agenda for the September 12, 1944, meeting between Roosevelt and Churchill at the Second Quebec Conference, was intended to focus on military matters, and thus Hull did not attend the conference.<sup>57</sup> Halfway through the conference, Roosevelt invited Morgenthau to attend and address German economic issues with Churchill and his delegation. Both Roosevelt and Morgenthau were in agreement on both the postwar treatment of Germany and the continuation of Lend-Lease aid to Britain. The objective for the president was to get the British to agree to the Morgenthau Plan by the use of both

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<sup>55</sup> Ibid.

<sup>56</sup> Ibid., 1479.

<sup>57</sup> Notter, United States, and Department of State., *Postwar Foreign Policy Preparation, 1939-1945.*, 1949, 244.



the persuasion of Morgenthau, and the Treasury Department's power of the purse.<sup>58</sup> After some coercion at the conference, the deal was made. Roosevelt was successful in getting Churchill to sign an agreement endorsing Morgenthau's Plan while Churchill received a Lend-Lease commitment. Both the president and Morgenthau denied allegations of any quid-pro quo agreement. In a State Department memorandum addressing the agreement between the president and the prime minister, Morgenthau denied that there was any connection between the prime minister's acceptances of Treasury Department's policy for the harsh treatment of Germany and his success in obtaining a commitment from the United States for a second phase of Lend-Lease funds.<sup>59</sup> It seemed obvious to a skeptical Hull and Stimson that such a deal had taken place.

The Quebec Agreement upset Hull who, referring to the cessation of the Ottawa agreements, had a different set of priorities to negotiate with Britain. Hull remarked that there were a number of matters with respect to commercial policy that the State Department was working to get British concessions; however, because the president had given in on Lend-Lease aid, there was no hope of settling these matters.<sup>60</sup> At this time, the long-term goal of opening up free trade with the British Commonwealth nations was unlikely. The president had used his bargaining power to gain a policy goal that would harm the long-term policy objectives of the State Department. In a meeting at Hull's office, comments made by Hull expressing his displeasure with Roosevelt were recorded in the State department records.

<sup>58</sup> Kuklick, *American Policy and the Division of Germany; the Clash with Russia over Reparations.*, 54.

<sup>59</sup> State, "Foreign Relations of the United States. Conference at Quebec, 1944," 135.

<sup>60</sup> *Ibid.*, 138.

Secretary Hull was very disturbed by the fact that the President made the decision on lend-lease with Britain without prior consultation with men who had been working on the problem for a long time. He said that there were a number of matters with respect to commercial policy which they were trying to get from the British and which the British were running away from, and that they were delaying decisions on the lend-lease aid to Britain during Phase 2 in the hope of getting the other matters settled first. Now, however, the President had given away that bait.<sup>61</sup>

Hull felt that Roosevelt had acted improperly. He had given away the prize with no solid gain in return. Not only was the State Department neglected on the agreement, there were no economists in attendance at the conference. Both Roosevelt and Churchill approved the Quebec II agreement, which would have major implications for the postwar economy, without any consultation with US or British economic experts or foreign policy advisors.<sup>62</sup> By October 1944, Hull accepted that Roosevelt would not reverse himself on Germany. The signing of the Quebec II agreement by the president officially recognized the Morgenthau Plan as US policy, but this did not deter the State Department from working to moderate its effect.<sup>63</sup> Over the course of winter 1944–1945, the State Department tried to reassert and to refine its position in an attempt to work on the Treasury’s influence.

The State Department was in a difficult position during the winter of 1944–1945. After the Second Quebec Conference, Roosevelt turned his back entirely on all postwar

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<sup>61</sup> Ibid.

<sup>62</sup> Penrose, *Economic Planning for the Peace*, 258.

<sup>63</sup> State, “Foreign Relations of the United States. Conference at Quebec, 1944,” 344.

planning.<sup>64</sup> The president had done nothing to mediate the disagreement within his Cabinet, and then firmly voted in favor of the Morgenthau plan. Since the start of the dispute in August, all negotiations with the British and Soviet Allies over German policy had been gravely hampered. Attempts by the United States to either influence their Allies or to reach a consensus on postwar Germany had been frustrated.<sup>65</sup> During this environment of confusion, each Department did their best to influence the wording of JCS1067 being prepared for the upcoming occupation.

### The President's Influence over Planning

President Roosevelt had the final say when it came to postwar policy. He often acted as his own State Department. His lines of communications on foreign matters bypassed the State Department, and the ideas of the early postwar planners were definitely not welcome at the White House. Roosevelt also ignored the negotiations done by inter-allied agencies, like the European Advisory Commission (EAC), relying more on a small group of aids in the Executive Branch and personal friends.<sup>66</sup> His list of trusted foreign policy consultants and advisors, including Henry Morgenthau, Harry Hopkins, General Marshall, and his Chief of Staff Admiral Leahy, was short.<sup>67</sup> The insulated policy generating environment created by the president left US planners and inter-allied negotiators in a state of paralysis.

In 1944 and early 1945 the White House managed all the central threads of German occupation planning. Implementation of policy was difficult because from the

<sup>64</sup> Penrose, *Economic Planning for the Peace*, 263.

<sup>65</sup> *Ibid.*, 259.

<sup>66</sup> Edward R. Stettinius, *The Economic Basis for Lasting Peace* / (Washington: 1945), 12, <http://hdl.handle.net/2027/uiug.30112101932728>.

<sup>67</sup> Petrov, *Money and Conquest; Allied Occupation Currencies in World War II.*, 149.

start of the war many of Roosevelt's positions were either unknown or unclear to those who had to execute them.<sup>68</sup> He frequently had left the State Department uninformed on major foreign policy matters. For example, in 1933, Roosevelt decided to recognize the USSR without consulting the State Department; in 1943, Hull was not allowed to see any of the conference notes from the Teheran Conference; and in 1944, at the Second Quebec Conference, Roosevelt decided unilaterally that the Morgenthau Plan would be official US postwar policy.<sup>69</sup> After September 1944, the president had ostracized the State Department to such an extent that any further policy rearguing Germany had to be cleared with the Treasury Department.<sup>70</sup> During this dark period, in the face of overwhelming alienation, the State Department did not change its policy pursuits but did their best to work from lower levels to influence the development of the directive.

It had been decided, at the Moscow Conference in 1943, to establish the European Advisory Commission as the proper body to carry out negotiations over postwar German matters. On several occasions during the tenure of the EAC; the negotiators were ready to form a policy, but the White House held them at a standstill. Even though both the British Foreign Office and the US State Department were in complete support of EAC negotiations, it seemed conclusive that the president did not respect the policy-making qualifications of the EAC.<sup>71</sup> As late as October 1944, the president reported to Hull that it was not advisable for the United States to make plans for a country that they did not yet occupy. Also, the president advised Hull not to give any weight to the negotiations taking place with our principal Allies. He reminded Hull that the purpose of the EAC was

<sup>68</sup> Stimson, *On Active Service in Peace and War*, 562.

<sup>69</sup> Dietrich, *The Morgenthau Plan Soviet Influence on American Postwar Policy*, 47.

<sup>70</sup> Kimball, *Swords or Ploughshares?*, 46.

<sup>71</sup> Penrose, *Economic Planning for the Peace*, 261.

“Advisory” and they are not bound by their recommendations.<sup>72</sup> This was Roosevelt’s leadership style. He would make important decisions with a few close aids and preferred to delay all decisions as long as possible. He rarely read or followed the advisement of State Department memoranda, despite having no training in these difficult matters.<sup>73</sup> The president’s style and attitude had an adverse effect on how the Soviets and the British approached the occupation. The postponement of major decisions had an undesirable effect on postwar cooperation and was expected to have a detrimental effect on the reconstruction of the German economy.

Roosevelt had only a passing interest in multilateralism. His postwar interests were more selective than that of the State Department. His advocacy for free and equal trade varied by circumstance.<sup>74</sup> His main foreign policy agenda was dominated by a large deference for the welfare of the British people. When it came to Hull’s principle on free and unrestricted trade for all, including Great Britain and Germany, the president did not agree. Great Britain would be allowed to keep its Imperial trading system, while Germany’s industrial trade would have to be diminished.<sup>75</sup> Roosevelt’s policy of picking winners like Britain and losers like Germany for the postwar world was in direct conflict with the multilateral principles laid down by the State Department.

It was predicable that the chaotic policy advanced by Roosevelt and Morgenthau would lead to the collapse of the German economy and possibly much of Europe. Poor planning would lead to a drain on US taxpayers and the potential starvation of thousands

<sup>72</sup> State, “Foreign Relations of the United States. Conference at Quebec, 1944,” 358.

<sup>73</sup> Stimson, *On Active Service in Peace and War*, 575.

<sup>74</sup> Kuklick, *American Policy and the Division of Germany; the Clash with Russia over Reparations.*, 17.

<sup>75</sup> Hull, *The Memoirs of Cordell Hull*, 1948, 1620.

of Germans.<sup>76</sup> This was the exact situation that State Department planners had been working to avoid since 1939. Hull, Pasvolsky, Welles, and Bowman, despite their individual feelings about Germans, believed that the opportunity for the United States at the end of WWII should be used to do more than to just settle accounts.

### JCS1067 and a Period of Deficient Planning

The end product of Roosevelt and Morgenthau's punitive treatment for Germany was the military directive JCS1067. As E.F. Penrose stated, "It was President Roosevelt's failure to adjudicate decisively between incompatible views among his Cabinet officers that led to a "compromise" drawn up at "lower levels" which permitted large parts of the Morgenthau Plan to creep in."<sup>77</sup> The process of writing JCS1067 was started in the fall of 1944 after the Second Quebec Conference, and over the next six months it went through a series of revisions until it was given to US Occupation Commander in Germany General Lucius D. Clay on April 26 1945.<sup>78</sup> On that date, German deindustrialization and economic chaos became official US occupation policy.

On November 30, 1944, Hull resigned as Secretary of State, succeeded by Edward Stettinius, Jr. Because of Hull's retirement, the State Department was at a significant disadvantage during the process of creating JCS1067. Despite the change at State Department, officials did what they could to weaken the overall concept of the Morgenthau Plan. Alternatives offered to the text of the directive were subtle but crucially different. McCloy, who worked in conjunction with the State and Treasury Departments, finally settled for language that called for military control of the economy

<sup>76</sup> Dietrich, *The Morgenthau Plan Soviet Influence on American Postwar Policy*, 88.

<sup>77</sup> Penrose, *Economic Planning for the Peace*, 294.

<sup>78</sup> Petrov, *Money and Conquest; Allied Occupation Currencies in World War II.*, 166.

while taking no steps toward rehabilitation.<sup>79</sup> The wording may not have been favorable to the State Department, but at least those at the War Department in charge of the occupation were not in favor of destroying the German industry and had given themselves enough flexibility room to maneuver.

Roosevelt and Morgenthau had hoped that the new directive could be applied to all of Germany, but after it was presented at the EAC in spring of 1945, it was rejected by Britain and the Soviets. As early as September of 1944, Dr. Pasvolsky was told by A.A. Sobolev, Vice Chairman of the Soviet delegation to the Dumbarton Oaks Conference, that “Mr. Morgenthau’s type of thinking was not acceptable to the Soviet Government.”<sup>80</sup> At this time, both the United States and the Soviets had hopes of a united Germany under their particular influence. Although in 1945 Soviet policy was not clear to the United States, it should have been obvious that during the occupation, the Soviets could use JCS1067 against the United States to gain support among the German people.

Despite the outcome of the Second Quebec Conference, the British also refused to accept JCS1067 as a combined Anglo-American policy. In a memorandum prepared by the Acting Secretary of State Stettinius on November 29, 1944, it was noted, “British officials seem strongly opposed to sweeping measures of de-industrialization and extreme impoverishment of Germany.”<sup>81</sup> The British developed their own liberal directive intending to preserve the basic structure of the German economy, a policy for which Morgenthau severely criticized British officials.<sup>82</sup> The British government was not in

<sup>79</sup> Kimball, *Swords or Ploughshares?*, 45.

<sup>80</sup> Kuklick, *American Policy and the Division of Germany; the Clash with Russia over Reparations.*, 71.

<sup>81</sup> State, “Foreign Relations of the United States. Conference at Quebec, 1944,” 413.

<sup>82</sup> Kimball, *Swords or Ploughshares?*, 47.

support of a punitive treatment for postwar Germany. The deal made between Churchill and Roosevelt at Quebec was quickly rejected by London.<sup>83</sup>

As JCS1067 became available in the spring of 1945, the new president, Harry S. Truman, supported Stimson and gave the military full authority to run the German occupation. In April 1945, the final draft directive seemed much better to Stimson than the earlier drafts. It did not approve action to strengthen the German economy but at least it did not call for its destruction. McCloy made sure that the style of phrasing used would give the military enough latitude and escape clauses to administer the occupation, as they deemed necessary.<sup>84</sup> The final version of JCS1067 was opposed by the State Department and signified a policy victory for the Treasury Department. Morgenthau was happy with JCS1067, later commenting that it included all the essential elements of the Morgenthau Plan.<sup>85</sup> With the Truman administration reliance on the War Department while trying to gain control of the situation, the State Department under the new direction of Edward Stettinius, Jr., was further removed from having significant influence over occupation policy during the early days of postwar Germany.

JCS1067 was eventually abandoned as a policy in 1947. The directive was a poorly conceived policy based on revenge. Lewis Douglas, appointed as economic advisor to General Clay in April 1944, when first reading the directive was quoted, “This thing was assembled by economic idiots”<sup>86</sup> Douglas believed that the policy stipulated in JCS1067 was unworkable in occupied Germany. His first assignment was to fly back to Washington to try to get JSC1067 replaced. He was unsuccessful and, as a consequence,

<sup>83</sup> State, “Foreign Relations of the United States. Conference at Quebec, 1944,” 142.

<sup>84</sup> Petrov, *Money and Conquest; Allied Occupation Currencies in World War II.*, 170.

<sup>85</sup> Schmitz, *Henry L. Stimson*, 185.

<sup>86</sup> Dietrich, *The Morgenthau Plan Soviet Influence on American Postwar Policy*, 80.



resigned his position. The implementation of Morgenthau's policy built into JCS1067 at the start the postwar German occupation was a tragedy. It dragged all of Europe down, cost US taxpayers hundreds of millions of dollars, financed Soviets reparation removals from Germany at the expense of the United States, and caused needless starvation and poverty.

## Chapter IV

### 1945–1948: The Occupation Period

#### Redressing US Occupation Policy

The occupation of Germany was a period marked by changing policies. Despite starting out as punitive, occupation policy gradually evolved to promote economic prosperity. The Potsdam Agreement of August 1945 was similar to the JCS1067 directive drafted earlier that year; both projected a get-tough attitude. However, by 1947, the United States was transitioning to a program of promoting prosperity, a policy position similar to what was proposed by early postwar planners from the State Department. This was not true of all policy issues. All US policy positions were critical of German industrial cartels; therefore, policy toward cartels started out restrictive and remained that way throughout the occupation period. When it came to policy addressing reparation payments, industrial output, and separation of the Ruhr, US policy started out harsh and moderated over time by limiting reparations, increasing industrial output, and opposing separation of the Ruhr. Policy regarding the partition of Germany became more complicated. Initially, the US Treasury Department favored the partition of Germany, whereas the State Department was strongly opposed to partition. Over time, the State Department increasingly found itself in support of partition, a change that would lead to the eventual division of Germany. It did so to promote multilateral economic prosperity in the part of Germany that was under the control of the United States. On every issue, the eventual policy outcome was one that intended to maximize the implementation of a

multilateral economic system in Germany along the lines of what was recommended by the early State Department planners.

The central dilemma faced by the United States at the start of the occupation period was that a potentially high-powered German industrial economy was both the problem and the solution to postwar problems. At the end of WWII, there was a legitimate concern that a dominant German industrial economy could again threaten Europe. Official US policy linked peace and security with a crippled Germany. Many, including those at the US State Department, recognized that a prosperous Europe could be a peaceful Europe and that prosperity would depend on a strong German industrial base. Various US governmental agencies struggled with both sides of this dilemma, causing a bifurcated policy approach to be applied to Germany during the early occupation period. While a punitive Potsdam agreement was officially in place, the US War and State Departments increasingly implemented policy that would serve to revive the German economy. As time went on, most US governmental departments were increasingly sidestepping the application of official US policy.

The endorsement of JCS1067 in the first half of 1945 and the negotiations at the Potsdam Conference by the Truman administration in the summer of 1945 overlooked the importance of the German industrial economy to both the world and Europe. It was unrealistic for US officials to think that the dynamic engine of German industry could be either ignored or dismantled and sent to other European nations. During most of the previous century, Germany played a central role in the European market. Throughout the 1920s, Germany was the leading consumer for goods produced by Italy and Switzerland, the second best consumer for goods produced by Denmark, Holland, and the British Isles,

and the third best consumer for goods produced by the United States. In the 1920s, the United States exported more goods to pre-Nazi Germany than to all South American nations combined.<sup>1</sup> The State Department recognized that the US get-tough policy underestimated Germany's position in world markets. The historical scope of German participation in the international economy was too important to be eliminated.

A key point argued by early postwar planners at the State Department was that a modern prosperous world economy was multilateral in nature. JCS1067 and the Potsdam Agreement disregarded this principle, ignoring the interconnectedness of German industry both inside Germany and throughout the European continent. The implementation of these two plans effectively cut off European trade from German coal production and machine building industries; this severely limited the possibility of using German trade to help rebuild the European economy.<sup>2</sup> The division of Germany into occupation zones by the Allies also crippled the movement of trade. US State Department briefing papers created for the Potsdam Conference repeatedly warned of the serious consequences if the German economy was not managed as a single economic unit.<sup>3</sup> These warnings were not taken seriously as the separation of Germany into four separate occupation zones served to limit commercial activity. The German national economy, which had been interdependent, was now divided and disconnected by four differing occupational policies.

In 1945, at the start of the occupation, the US State Department had to take a backseat to the War Department and the Executive Branch on policy matters concerning

<sup>1</sup> Ferdinand A. Hermens, "The Economics of Potsdam," *The Review of Politics* 8, no. 3 (July 1, 1946): 387.

<sup>2</sup> Alan Kramer, *West German Economy, 1945-1955*, First Edition (Oxford: Berg Publishers, 1991), 59.

<sup>3</sup> United States Department of State, "Foreign Relations of the United States : Diplomatic Papers : The Conference of Berlin (the Potsdam Conference), 1945, 1945, 440, <http://digicoll.library.wisc.edu/cgi-bin/FRUS/FRUS>.

the German occupation. This was the case for a variety of reasons. First, there were changes in leadership at the top levels of the US government. A new Secretary of State, James F. Byrnes, was sworn into office in July 1945, and the Truman Administration, which had been in office only a few months, was still trying to assert itself. Second, there was already a strong military presence in place in Germany asserting its own agenda. Finally, the State Department had just lost its interdepartmental struggle with the US Treasury and Executive branches. These circumstances put the State Department in a temporary position of weakness.<sup>4</sup> This turned out to be a short-term setback, as State Department policies gradually became more influential over the next two years. This reversal occurred in three ways. First, over time, both the military personnel in Germany and Executive Department officials in Washington were changing policy recommendations to align closer to what the State Department had been advocating. Second, State Department officials increasingly gained more direct responsibility for the occupation. Finally, there was a change in the nature of the occupation as the focus of policy on Germany changed from an interdepartmental disagreement within the US government to an external struggle between the United States and its former Allies. This change in the nature of the disagreement necessitated the United States to readjust its policy closer to State Department recommendations.

By the start of the occupation, US State Department officials had spent a number of years planning for the postwar period. They had anticipated major problems that other US Government officials had not foreseen. Before JCS1067 and the Potsdam Conference, they warned of a critical need for coal in Europe and expressed concerns that Germany would be in a crisis condition if it was not be operated as a single economic unit. This

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<sup>4</sup> E. F. Penrose, *Economic Planning for the Peace* (Princeton: Princeton University Press, 1953), 237.

was evident in policy briefing papers generated by the State Department for the Potsdam Conference in July 1945.<sup>5</sup> These documents pointed out that an adequate distribution of coal was of key importance to all European countries. An acute shortage would be the most important obstacle to economic recovery. Briefing papers recommended that a maximum effort must be made to resolve the German coal problem as soon as possible.<sup>6</sup> This documentation recommended that from 1945–1946, both German and Polish production facilities would need to get back on schedule quickly to meet the continent’s minimum needs. Four critical areas would need immediate and concurrent attention: increased coal production, the revival of coal transportation, an increase in the general level of the economy, and the nation-wide integration of the German coal industry.<sup>7</sup> Briefing papers written for the Potsdam Conference detailed a knowledgeable understanding by the US State Department of imminent problems that would be faced during the occupation. They were remarkably consistent with multilateral policy plans developed by the early planners at the State Department. While confirming that the needs of Allied nations take precedence over the needs of Germany, they understood that the general level of the entire German economy must be increased concurrently for all of Europe to recover.

State Department Policy Briefing papers expressed concern over the possibility that the occupation zones would act independently. They stressed that Germany must operate as a single economic unit: “The division of Germany into zones of occupation does not imply in the erection of barriers to the inter-zonal movement of goods.”<sup>8</sup> The

<sup>5</sup> State, “Foreign Relations of the United States,” 435.

<sup>6</sup> Ibid., 608.

<sup>7</sup> Ibid., 609.

<sup>8</sup> Ibid., 440.

State Department warned that the operation of the zones as closed economic entities would be utterly impracticable. In general, the US zone needed food, industrial materials, and coal; the British zone needed food, but had an excess of coal and industrial materials; and the Russian zone had an excess of food and coal.<sup>9</sup> By the summer of 1945, the matter of a unified Germany had not yet been raised by the Soviet Union, with the exception of reparations. It had been evident since the Tehran Conference in December 1943 that a main objective for the Soviets was a large reparations settlement. The operation of Germany as a single economic unit could not be broached with the Soviets until they received a suitable reparations deal.<sup>10</sup> By June 1945, the Soviets had already taken large quantities of reparations from their zone and were stalling further negotiations for the economic unity of Germany until a suitable settlement was reached over reparation removals from the Western zones.

At the start of the occupation period, critical policy decisions had been delayed, and the possibility of a coal shortage and the economic partition of Germany was already a concern at the State Department. Matters had already been delayed as a result of the US interdepartmental disagreement over postwar policy. It appeared that a roadblock over a Soviet reparations agreement was going to cause a further delay on important policy decisions.<sup>11</sup> Issues necessary for a viable German economy, such as the freedom of movement, rebuilding a national transportation system, uniform ration scale, uniform industrial and agricultural policies, centralized currency, and a national import-export

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<sup>9</sup> Ibid., 607.

<sup>10</sup> Ibid., 440.

<sup>11</sup> Bruce Kuklick, *American Policy and the Division of Germany; the Clash with Russia over Reparations*. (Ithaca NYCornell University Press 1972, 1972), 220.

agreement, had not yet been considered.<sup>12</sup> As early as June 1945, State Department briefing papers expressed apprehension about the urgency of these matters and further delay would lead to economic partition. For the first time, the State Department considered the possibility that an agreement with the Soviets might not be reached. The urgency of these problems required the need for prompt decisions, even if it meant the exclusion of the Soviets. Even before the Potsdam Conference, the State Department felt that it would soon become necessary to make arrangements with other Allies, limiting policy application to only the US and British zones.<sup>13</sup> There was still hope that the upcoming Potsdam Conference would address these issues, but the time was fast approaching in which the Western Allies would have to act to unify economic activity exclusively in their own Western zones to avert chaos and disorder.

There was a window of opportunity early in the occupation to solve these matters. In the late spring and early summer of 1945, there was a great amount of goodwill toward the Russians, and the attitude of the American people toward the Soviets at the time of surrender was overwhelmingly optimistic. Many Americans felt that as a result of the common cause and suffering, the two nations would come to agreement over the future of Europe. Byrnes believed that at the end of the war, peace would be so deeply desired that the Allies would have little difficulty in resolving European issues. The United States had concerns over Soviet policy in Poland and Romania, but there was optimism that these problems could be worked out.<sup>14</sup> Despite concerns over the slow pace of negotiations, the State Department felt positive that it might not be too late for cooperation on Germany.

<sup>12</sup> State, "Foreign Relations of the United States," 441.

<sup>13</sup> *Ibid.*, 607.

<sup>14</sup> Byrnes, James F., *Speaking Frankly*, 1st. ed (New York: Harper & Brothers Publishers, 1947), 71.



Although officials at the State Department were the last US governmental agency to lose hope in coming to an agreement with the Soviets, their feelings of optimism turned out to be unrealistic. By early summer of 1945, problems were already starting to develop. The State Department was not immune from criticism; it had been planning for the long term and did not devote enough attention to short-term planning; the official punitive policy in place made for a difficult start to the occupation. The authorities in Washington who prepared JCS1067 did not grasp the realities of conditions in postwar Germany. The initial problem was not that JCS1067 promoted a hard peace over a soft peace; the problem was that conditions on the ground were much more challenging than expected. State Department policy focused on trying to determine the exact level of industry necessary to fit the German economy in its proper place among European nations during normal times. The real focus should have been on preparing the economy to recover as fast as possible in order to avoid a near-term economic disaster. JCS1067 called for the German economy to be controlled by the US military to only the extent necessary to meet the needs of occupation forces and to prevent disease and unrest. The directive gave limited authority to the Military government and prohibited any steps being taken to rehabilitate or maintain the German economy.<sup>15</sup> General Clay was blocked from taking action on two fronts: (1) the restrictive nature of JCS1067 and (2) the Allied occupational structure set up to run postwar Germany, the Allied Control Council (ACC), called for a unanimous vote before any action could be taken.<sup>16</sup> A single veto by any Ally, British, Soviet, or French, could put a stop to any policy in Germany. Clay, who felt

<sup>15</sup> Lucius D. Clay, in, United States Dept of State Office of Public Affairs, *Germany, 1947-1949: The Story in Documents Prepared by Velma Hastings Cassidy, of the Division of Historical Policy Research, Office of Public ... of the Bureau of German Affairs* (University of Michigan Library, 1950), 27.

<sup>16</sup> Lucius D. Clay, *Decision in Germany* (Garden City, N.Y.: Doubleday, 1950), 17.

unable to intervene, understood that thousands of Germans would starve unless immediate action was taken to revive industrial production.

After the first troubled year of occupation, Clay directed the US military to produce the publication *A Year of Potsdam, The German Economy Since the Surrender*.<sup>17</sup> In this publication, Clay was critical of how the Potsdam Agreement was harmful to the postwar occupation of Germany. Much of the Morgenthau spirit survived after he left the Treasury Department and had been written into the Potsdam Agreement.<sup>18</sup> Potsdam policy was aimed at destroying Germany's import-export system by the use of industrial restrictions and by overzealous reparation removals. In a response to this problem, the publication was used by US military officials to argue that Germany had always been heavily dependent on imports and its economy based on a system of combining German labor with imported raw materials to manufacture finished machinery and metals. The end of WWII had brought on a complex problem of reviving foreign trade in a defeated and bankrupt nation. The removal of capital equipment had been targeted at Germany's most productive industries. If its traditional heavy industrial base were to be destroyed, it would end Germany's ability to become self-sufficient.<sup>19</sup> The War Department was looking to free itself from the restrictions of JCS1067 and the Potsdam Agreement. With the use of this publication, Clay was seeking unrestricted authority to revive the German economy to the fullest extent. This would serve to make the military's job easier, reduce the burden on US taxpayers, and allow Germany democratic forces an easier time in resisting Soviet influence. The policy position of Clay and the US military was different

<sup>17</sup> Germany, Military Governor, "A Year of Potsdam, the German Economy since the Surrender," 1945, <http://digioll.library.wisc.edu/cgi-bin/History/History>.

<sup>18</sup> Penrose, *Economic Planning for the Peace*, 294.

<sup>19</sup> Occupation and Governor, "A Year of Potsdam, the German Economy since the Surrender," 153.

than the policy position of the State Department.<sup>20</sup> The State Department was in favor of a revival only to a certain degree, to be used for the purpose of rebuilding all the nations of Europe, a multilateral prosperity for victors and vanquished alike.

Changes in US policy between 1945 and 1947 were gradual. Even though Morgenthau resigned from the Treasury in the summer of 1945, vestiges of the Treasury's putative influence remained strong among the lower ranks for the first two years of occupation.<sup>21</sup> Reparation policy during the early occupation period was still operating under the shadow of a Morgenthau-type de-industrialization. It was not until the folly of trying to run a balanced German economy while shipping off German industrial capital to the Soviets that the punitive policy was perceived as a serious mistake. When faced with what appeared to be a complete collapse of the German economy, many occupation officials who started out determined to destroy Germany's industrial capacity steadily evolved into advocates of economic recovery.<sup>22</sup> By 1946, State Department officials and the US military started to work for solutions. In April 1946, Clay made the first bold move by stopping all dismantling of German industry for shipment to the Soviets.<sup>23</sup> Then he used his influence to change the structure of British coal production in the Ruhr. Whereas both the United States and Britain agreed that more German coal was urgently needed to revive the European economy, they differed on how the Ruhr coal production should be administered. The British insisted that the Ruhr be nationalized, while US officials held that coal mines would operate more productively if they remained under private ownership and were run by experienced German executives.

<sup>20</sup> Kuklick, *American Policy and the Division of Germany; the Clash with Russia over Reparations.*, 118.

<sup>21</sup> Penrose, *Economic Planning for the Peace*, 295.

<sup>22</sup> James C Van Hook, *Rebuilding Germany: The Creation of the Social Market Economy, 1945 - 1957* (Cambridge: Cambridge Univ. Press, 2004), 42.

<sup>23</sup> Occupation and Governor, "A Year of Potsdam, the German Economy since the Surrender," 155.

A decision was made on September 10, 1946 in favor of Clay's position; the Ruhr's coal industry would not be nationalized but returned to German management as a means to boost output.<sup>24</sup> The change to German management and control was done to maximize coal production in the Ruhr. By 1946, the need to change policy was driven more by economic urgency than by political objectives.

By 1947, it became evident to the State Department that the United States had grossly underestimated the destruction of the European economy by the war. "We failed to take fully into account the effects of economic dislocation on production-nationalization of industries, drastic land reform, severance of long-standing commercial ties, disappearance of private commercial firms through death or loss of capital."<sup>25</sup> Europe was steadily deteriorating; by 1947, malnutrition had peaked, and millions of people in German cities were slowly starving.<sup>26</sup> The modern division of labor system in Europe had broken down. Nations were still running continual deficits. In 1946, the United Kingdom had a balance of payments deficit of 2¼ billion, France 1¼ billion, Italy ½ billion, and in the US occupied German zone ½ billion.<sup>27</sup> It had been two years since the end of the war and a corner had not yet been turned. Economies in Europe were deteriorating, and the hope of reassembling a multilateral trade system among nations had not yet been realized.

<sup>24</sup> United States Department of State, "Foreign Relations of the United States, 1947. Council of Foreign Ministers; Germany and Austria," 1947, 966, <http://digicoll.library.wisc.edu/cgi-bin/FRUS/FRUS>.

<sup>25</sup> *Ibid.*, 230.

<sup>26</sup> Clay, *Decision in Germany*, 268.

<sup>27</sup> State, "Foreign Relations of the United States, 1947. Council of Foreign Ministers; Germany and Austria," 230.

## Eliminating German Cartels

Before multilateral foreign trade could be restarted, the problem of controlling German industry had to be solved. German industry was not going to be allowed to become the master of the Europe continent. To varying degrees, the United States, Great Britain, and the Soviets all believed that the social structure of industry in Germany was the major cause of economic aggression.<sup>28</sup> The persistent power of German elites and the monopoly capitalists had retarded the nations democratic development. The problem accelerated after WWI as control of the German economy became increasingly concentrated in the hands of a few people. This went beyond just the means of production ownership; the structure in Germany involved a collaborative and cohesive economic empire, a nefarious partnership of private business and a militaristic government.<sup>29</sup> The United States was of one mind on this point, the concentrated structure of the German economy was inconsistent with the future of peace and democracy, and the job of the occupation forces was to disassemble that structure.

Large industrial firms were a primary target of the occupation; the larger the firm, the more intense the scrutiny.<sup>30</sup> German cartels were a particular concern because of their horizontal control of broad markets. All branches of the US government stood firm and unanimous against this form of market control. The United States held a unique view on industrial concentration. Unlike the British and the Soviets who accepted the usefulness of large blocks of economic concentration for use as agents of social reform, the United States worked to reduce all institutions of economic concentration for the prerequisite of

<sup>28</sup> Van Hook, *Rebuilding Germany*, 57.

<sup>29</sup> Occupation and Governor, "A Year of Potsdam, the German Economy since the Surrender," 189.

<sup>30</sup> Jonathan Zeitlin, *Americanization and Its Limits: Reworking US Technology and Management in Post-War Europe and Japan* / Herrigel, Gary. (Oxford, UK ; New York: Oxford University Press, 2000), 359.

promoting competition.<sup>31</sup> All US occupation policymakers agreed on this particular issue. Large concentrations of economic power were to be broken up, and all cartels and cartel-like organizations were to be disbanded.<sup>32</sup> Postwar Germany was to be decentralized by the elimination of excess concentration of economic power comprised of cartels, trusts, and monopolies.

US officials did not view cartels as dynamic and efficient; they viewed them as archaic. Cartels blocked the diffusion of efficient technologies, stifled innovation, and created a dangerous authoritarian power structure within the economy.<sup>33</sup> They eliminated horizontal diversification and limited the ability of market forces to work the benefit of the general public. Cartels catered production to the needs of the elite; their elimination would go a long way to change the structure of the German economy. Through the process of decartelization, German capitalism could be restructured to resemble US capitalism, the mass production of standardized goods for mass distribution. US policy was predicated on the establishment of an egalitarian economy as a necessary step toward a more democratic German society.

There were two different ways in which US policy makers viewed the relevance of German industry; some felt that because of its centralized and monopolistic nature, German industry was artificial and not vital to Europe. The Potsdam Agreement, which had little input from the State Department, was based on this presumption. The claim of “artificial” was based on the belief that the strength of German industry was due to the exclusion of foreign competition by the use of import duties and its prominence inflated

<sup>31</sup> Van Hook, *Rebuilding Germany*, 82.

<sup>32</sup> Clay, *Decision in Germany*, 18.

<sup>33</sup> Zeitlin, *Americanization and Its Limits*, 399.

by use of political coercion.<sup>34</sup> The economic rationale behind the Potsdam Agreement argued that the breakdown of the international economic system during the 1930s was due to a coercive German industrial structure that dominated the European market. In a free and competitive economy, German industry would not be able to compete. The Potsdam agreement called for this industrial structure to be disassembled and relocated elsewhere in Europe.

Other policy makers like those in the US State Department believed that German industry held a vital place in the European economy and was essential to its prosperity. Germany's central position in Europe, its excellent railway network, communication systems, and strong domestic markets made it naturally strong and competitive. When you add its coal resources, rivers and canals, and the industrial skills developed during the last few generations you have all the essential ingredients for a vibrant economy.<sup>35</sup> US officials at the State Department who held this view believed that Germany should be reorganized, not dismantled. They believed that the German industrial system was the center around which the European system moved.<sup>36</sup> In short, remove the cancer (cartels), and the patient (Germany) could be saved.

In the summer of 1945, the United States launched a rigorous attack on German cartels.<sup>37</sup> Paragraph 12 of the Potsdam Declaration stated that the German economy would be decentralized to eliminate excessive concentrations of economic power held by cartels, trusts, and monopolies.<sup>38</sup> I.G. Farben, the world's largest chemical company and

<sup>34</sup> Hermens, "The Economics of Potsdam," 388.

<sup>35</sup> Ibid.

<sup>36</sup> Van Hook, *Rebuilding Germany*, 57.

<sup>37</sup> S. Jonathan Wiesen, *West German Industry and the Challenge of the Nazi Past, 1945-1955*, New edition (Chapel Hill: The University of North Carolina Press, 2004), 43.

<sup>38</sup> Occupation and Governor, "A Year of Potsdam, the German Economy since the Surrender," 188.

Hitler's major producer of war material, known as a "State within a State," was forced out of existence. US occupation officials took control of 42 of its manufacturing plants, dissolved the firm, and then reorganized it into 52 independent operations. By 1946, occupation forces had terminated 1,000 cartel and restrictive trade practices.

Decartelization policy remained a priority throughout the occupation period. The criteria used to define a firm as a cartel were based on its number of employees. Law 56, passed by US occupation forces in February 1947, required any firm headquartered in the US zone having over 10,000 employees be deconcentrated unless given a specific exemption by the military government. A similar law was concurrently enacted in the British zone.<sup>39</sup> Some other firms that were broken up included major Ruhr steel producers, like Vestag and Krupp, and the six largest banks, including Deutsche, Dresdner, and Commerz Banks.<sup>40</sup>

There was a great expectation on the part of US officials that decartelization would be a major feature in the reorganization of the German economy. All sides in the US policy debate were in favor of this policy. The United States had a recent history of trust-busting legislation; it was seen as a necessary historical process that German capitalism had not gone through yet. Evidence of this deeply held conviction could be seen in a report issued in the summer of 1945 by the US Senate Committee on War Mobilization. They were investigating the possibility that German conspirators were attempting to create economic reserves inside and outside Germany for another attempt at world conquest. The committee was concerned that if Germany was not changed, they would soon start WWII. The committee's final recommendation was that pressure be put

<sup>39</sup> Clay, *Decision in Germany*, 326.

<sup>40</sup> Zeitlin, *Americanization and Its Limits*, 363.



on US occupation forces to thoroughly complete the decartelization of the German economy.<sup>41</sup> The conviction of the committee that cartels were a prime force behind Nazi aggression and that a systematic removal of industrial cartels would ensure the peace is an example of how firmly US officials held this view.

### Germany Moves Toward a Crisis

At the start of the occupation period, the foreign policy apparatus of the United States was adrift. President Truman was inexperienced in foreign affairs, Byrnes was essentially a domestic politician, and there was an unsettled departmental disagreement that carried over from the Roosevelt administration. There was no one document or paper that spelled out a comprehensive policy toward Germany. There was no one leader, like Stalin for the Soviets, who dominated national policy decisions. Byrnes was not a forceful leader, he believed that the State Department should limit itself strictly to policymaking and not become involved in the control of occupational organizations. Byrnes was willing to let the State Department stand back from the occupation; the State Department would recommend policy, the president would determine policy, and the War and Navy Departments would execute policy.<sup>42</sup> This was a responsibility that many in the military were reluctant to take, and those who did accept responsibility, like Clay, had their own ideas on how to run the German occupation. The second level of the State Department was comprised of a new group of officials who were committed to taking up the ideals of the early postwar planners. Assistant Secretary of State William Clayton, Ambassador to the USSR Averell Harriman, and Reparations Ambassador Edwin Pauley

<sup>41</sup> Van Hook, *Rebuilding Germany*, 43.

<sup>42</sup> Byrnes, James F., *Speaking Frankly*, 244.

all believed in the primacy of economic policy and the multilateral ideal.<sup>43</sup> As the occupation continued, this group of officials became more influential and pushed US policy toward a multilateral promotion of German prosperity.

When Clay left Washington on April 6, 1945 to take over command of the German occupation, he was not given any State Department briefings or policy papers to review.<sup>44</sup> He did not receive a copy of JCS1067 until after he arrived in Germany. This lack of policy briefing was not of great concern to Clay; he found the conditions on the ground in Germany so bad that short-term directives and long-term policy would take a backseat to immediate relief. The situation in Germany was unprecedented, Assistant Secretary of War John McCloy referred to it as “The most complete economic and political collapse in modern times.”<sup>45</sup> From the military’s perspective, the responsibility to carry out short-term policy, namely JCS1067, in itself was unrealistic. In the face of the destruction of war, just keeping the situation from degrading into chaos would be difficult. For the military officials in charge of the day-to-day operations, long-term goals were irrelevant and short-term planning was inadequate.

Cooperation between the Military and the State Departments in Germany got off to a slow start. Because of the need for immediate action, Clay and the military drifted toward a unilateral policy to keep the US zone afloat. Over time, Clay continued to practice a wide range of decision-making latitude to allow the military occupation to sustain. During the first two years of occupation, a number of decisions were made to improve the overall economic situation in Germany; however, some came at the expense

<sup>43</sup> Kuklick, *American Policy and the Division of Germany; the Clash with Russia over Reparations.*, 142.

<sup>44</sup> Clay, *Decision in Germany*, 6.

<sup>45</sup> John J. McCloy, “American Occupation Policies in Germany,” *Proceedings of the Academy of Political Science* 21, no. 4 (January 1, 1946): 542, doi:10.2307/1172904.

of other European nations. Clay's unilateral action was starting to become a problem; it was at odds with long-term State Department policy, which was based on the concept that before any action was taken in Germany, it should first be considered for its effects on the whole of Europe. By 1947, the State Department began to reassert itself. They urged that policy should be directed to the creation of an all-European economic organization designed to accelerate the lagging reconstruction and to achieve a greater long-run economic unity in Europe.<sup>46</sup> Policy from 1945 to 1947 was in a constant state of transition. Clay and the military were developing unilateral decisions to promote a successful occupation. Meanwhile, as the State Department began to regain its influence, it began working toward the long-term goal of rebuilding Europe as an integrated whole.

During the first two years of the occupation, US policy for Germany was bifurcated for a number of reasons. First, while Clay and the military were implementing short-term policy for reconstructing the German economy, the State Department was interested in changing the nature of the slow-moving German recovery from unilateral to multilateral. Second, the State Department was still trying to work with the Soviets to unify Germany; a consequence of this strategy was the willingness by the State Department to delay the full recovery of the German economy until unification could be achieved.<sup>47</sup> Third, the long-term goal of redeveloping the international commercial system on an egalitarian basis preempted any notion of a speedy recovery for Germany.<sup>48</sup> Finally, there was pressure by Congress to bring the troops home and cut occupational expenses. Roosevelt had told Stalin in 1944 that the United States would only leave

<sup>46</sup> Günter Bischof, "The Advent of Neo-Revisionism?," *Journal of Cold War Studies* 7, no. 1 (Winter 2005): 147, doi:10.1162/1520397053326176.

<sup>47</sup> Alan S. Milward, *The European Rescue of the Nation-State*, 2nd ed (London ; New York: Routledge, 2000), 73.

<sup>48</sup> Penrose, *Economic Planning for the Peace*, 332.

troops in Europe for two years. The Truman administration, also very concerned about finances, was apprehensive about providing financial support for the US occupation zone while sending reparations to the Soviets.<sup>49</sup> Clay was well aware of these feelings in Washington and, consequently, one of his paramount concerns was to make Germany self-sufficient to keep costs down to US taxpayers and permit a timely American withdrawal. By 1947, a crisis was developing in Germany, one that would unify US policy under the guidance of the State Department.

1947 was a turning point for the occupation of Germany. The winter of 1946–1947 had been the worst in decades; it was a time of crisis as the German people were running out of coal and food. Both the military occupational authorities and the State Department recognized that mistakes had been made. The United States had to reverse course and save as much of Germany as possible.<sup>50</sup> Coal and food production needed to be increased, industrial production needed to be expanded to help pay for imports, and a new policy would have to be developed to save the Western zones, even if it meant the partition of Germany. The State Department was forced to reevaluate its broad stance for European redevelopment and focus on economic development for Germany. This change can be identified by changes in policy toward the control of the Ruhr, reparation deliveries to the Soviets, and the level of German industrial production. The hardening of US policy in relation to these issues was bound to cause problems during the ongoing negotiations with the Soviets.

The major difficulty for the occupation was doing business with the Soviets who were antagonistic to multilateral economic policy. At the start of the occupation, State

<sup>49</sup> John H Backer, *The Decision to Divide Germany: American Foreign Policy in Transition* (Durham, N.C.: Duke University Press, 1978), 136.

<sup>50</sup> Penrose, *Economic Planning for the Peace*, 303.

Department policy anticipated cooperation with the Soviets on trade. In July 1945, Byrnes stated, “It is of course a prime objective of this Government to include the Soviets in any organization having to do with production, export, or allocation of German coal.”<sup>51</sup> Coal was the prime concern for the economy and the United States was eager to trade for Soviet zone coal. However, after two years, no progress had been made, and as a result, the United States was losing its willingness to negotiate. By 1947, Byrnes’ comments on Soviet cooperation had completely reversed: “They want to share in all decisions on the allocation of Ruhr products. Our experience on the Allied Control Council demonstrates how impractical this proposal is.”<sup>52</sup> By 1947, the Soviets felt they had been betrayed by the United States on reparation deliveries from the Western zones; they were not going to negotiate free trade for Germany until they received a suitable reparations agreement. The United States was committed to not giving in to reparations until there was free trade in all of Germany. An impasse had been reached in negotiations; if the Soviets would not supply coal from East Germany, they could not expect to have any control over the industrial production from the Ruhr.

The United States’ inability to open up all of Germany to free trade led directly to a change in policy on sending the Soviets reparations. This change had a longstanding impact on the future of Germany and increased the level of tension between the United States and the Soviet Union. At Potsdam, the United States had agreed to send the Soviets 10 percent of the industrial capacity of the Western zone within two years, assuming a united German economic system. After nine months and no Soviet cooperation on trade, Clay took a hard stand by designating that until the Soviets opened

<sup>51</sup> State, “Foreign Relations of the United States,” 628.

<sup>52</sup> Byrnes, James F., *Speaking Frankly*, 194.

up trade with the East, there would be no reparations from the West.<sup>53</sup> The position was firm. The United States would not pay for reparations again as it had after WWI. German capital equipment could not be given to the Soviets while the American taxpayer was paying for the support of the US zone. The United States then implemented the “First Charge Principle,” meaning that proceeds from exports of current production would first go to pay for needed imports, not to pay for Soviet claims.<sup>54</sup> It was possible that the United States may have to finance German reconstruction in its own zone, but it would not pay for reconstruction in the Soviet zone. To save the Western zones of Germany, the United States would have to divide it from the Eastern zone. Division was not the initial desire of anyone at the State Department, but if the Soviets would not allow Germany to integrate as one economic unit, then the United States would have no option but to integrate a separate West Germany economy exclusively with other Western economies.

As the occupation preceded, it became clearer to the State Department that plans to keep the German economy at a managed level of production were unworkable. State Department documents from before 1947 advocated for a moderately prosperous German economy, but accommodated the concerns of other nations over the potential of a renewed German threat by limiting German industrial production. However, by 1947, there was no longer a concern for a German threat; therefore, there was no need to restrict German industrial production. Briefing papers were calling for urgent action to increase the production of coal, food, and consumer goods.<sup>55</sup> The United States were calling for an increase in the German standard of living equal to their European neighbors as a

<sup>53</sup> Kuklick, *American Policy and the Division of Germany; the Clash with Russia over Reparations.*, 213.

<sup>54</sup> Occupation and Governor, “A Year of Potsdam, the German Economy since the Surrender,” 157.

<sup>55</sup> State, “Foreign Relations of the United States, 1947. Council of Foreign Ministers; Germany and Austria,” 219.

necessity for the development of a prosperous and democratic Germany.<sup>56</sup> As hopes for a multilateral vision for all of Europe ran into Soviet resistance, the United States had to retool its policy to restart the German industrial machine to benefit a stagnate Western European economy.

Policy concerning the control of the Ruhr was the subject of intense negotiation during the occupation period. In 1945, the French and some US officials wanted the Ruhr to be separated from the rest of Germany. Others, including the Soviets recommended that it be turned over to international ownership.<sup>57</sup> Other forms of control over the Ruhr were being discussed. Both Clay and officials at the State Department contended that Germany without the Ruhr could not be self-sustaining and that detachment would be contrary to the political and economic stability of Europe. US officials also believed that the population of the Ruhr would most likely be agitated until it was reunited with Germany.<sup>58</sup> By 1947, the United States had ruled out both the separation of the Ruhr from Germany and international ownership, but it did call for international supervision of the Ruhr resources to ensure equal access to all nations.

By the fall of 1947, the US State Department realized that early occupation policy designed to force the Soviets to accede to cooperation in Germany by withholding payments of reparations, denying Soviet control over resources from the Ruhr, or manipulating the level of industrial production, had failed. The result was the separation of the Soviet zone from the US, British, and French zones.<sup>59</sup> If the Soviets continued to oppose multilateralism, they would do so under economic handicap of exclusion from the

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<sup>56</sup> Ibid., 223.

<sup>57</sup> Van Hook, *Rebuilding Germany*, 57.

<sup>58</sup> United States Department of State, "Foreign Relations of the United States, 1946. Council of Foreign Ministers," 1946, 541, <http://digicoll.library.wisc.edu/cgi-bin/FRUS/FRUS>.

<sup>59</sup> Kuklick, *American Policy and the Division of Germany; the Clash with Russia over Reparations.*, 174.

Western European market. Conversely, the United States was willing to use its superior economic position to support Germany and other European nations willing to include their economies in a multilateral system. The State Department was the last US Department to give up hope for a united Germany, but once they realized they could not coerce the Soviets into multilateral participation in Germany, it was time to cut loose from the negotiations.

### US Policy and the Division of Germany

At the start of the occupation, the US State Department advised against the partition of Germany.<sup>60</sup> State Department briefing papers issued in July 1944 for the Potsdam Conference recommended that the United States should strongly oppose the partition of Germany. There were many reasons given: partition would break up Germany as an economic unity, it would be dangerous to the future peace in Europe, the current occupation zones would not work as plausible partition lines, and partition would have to be maintained by force. The State Department asserted that the Germans had become increasingly homogenous and would try to reunite. Most importantly, partition would be injurious to the rehabilitation of Europe and cause further expense for the United States.<sup>61</sup> The Soviets were also interested in the possibility of a united Germany; they had hopes of fostering Soviet influence over the entire country. Soviet promised that cooperation would be forthcoming if they would receive continued reparations payments from the Western zones and had access to a share of resources from the Ruhr. Only in 1948 did the Soviets finally abandon the idea of a united Germany.<sup>62</sup> At a speech given in

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<sup>60</sup> Ibid., 164.

<sup>61</sup> State, "Foreign Relations of the United States," 457.

<sup>62</sup> Kramer, *West German Economy, 1945-1955*, 35.



Stuttgart in September 1946, Byrnes restated future policy toward Germany, “The United States shall do everything in its power to secure the maximum possible unification.”<sup>63</sup>

Even though Clay had stopped reparations deliveries to the Soviets in the spring of 1946, it was not done with the intension of dividing Germany. It was an action taken by US military officials to improve conditions in the western zone. As of 1946, the US military was still determined to make cooperation with the Soviets work.<sup>64</sup> It was in the last half of 1946 that policy changed from cooperation to obstruction and hopes for a united Germany started to unwind.

There is much debate as to who was responsible for the division of Germany, but it seems clear that reparations were at the heart of the issue. Both sides were unsure of the other’s intentions. Both sides started the occupation with high hopes of a united Germany under the auspices of their own particular influences. The Russians placed a tremendous value on Communist success in Germany.<sup>65</sup> They believed that a postwar Germany was predisposed to become a communist nation, especially if the Soviets were in a position to influence local officials. The United States was determined that Germany should be part of a US lead multilateral group of capitalist nations. Some level of socialism would be acceptable, but national trade policy was to be open and free. The first priority for the Soviets was reparations, and until they received a suitable agreement, they would insist on a separation of zones. Acting Secretary of State Dean Acheson believed that the Soviets were playing a waiting game; they would keep a firm control over the Eastern zone until a time came when the United States pulled out, and then a united Germany

<sup>63</sup> James F Byrnes, in, *Germany, 1947-1949*, 5.

<sup>64</sup> Kramer, *West German Economy, 1945-1955*, 55.

<sup>65</sup> State, “Foreign Relations of the United States, 1946. Council of Foreign Ministers,” 555.

under Soviet influence would become a possibility.<sup>66</sup> There seemed to be no solution to the US-Soviet deadlock.

The Soviets and the United States were not the only foreign powers with concerns about the German settlement. State Department preparation papers for the Moscow Conference of Foreign Ministers (CFM) in March 1948 reveal deep concerns about French obstruction to German economic unity. The French continue to veto any policy that would allow for central German authority. They have been the most determined opponent of economic unification of Germany and the establishment of central German agency. They will not likely relent until the Ruhr issue is settled.<sup>67</sup> The French were not included in the Potsdam Conference and did not consider themselves bound by the agreement. At the start of the occupation, the French wanted the Ruhr separated from Germany, but by 1948, they had become willing to talk about other options, such as internationalization of the Ruhr.

By 1947, the issue of the Ruhr became central. The United States had staked its hope for future European prosperity on this rich industrial district. Despite concerns over a renewal of German economic power in Europe and the Soviet desire to gain access to the its industrial output, the United States became steadfast in its determination to find a solution to using the Ruhr's industrial output to revive Western Europe. US State Department documents addressed these policy concerns: "unfettered German control of the vital coal and iron and steel resources of the Ruhr would leave many European countries which are deeply dependent on the Ruhr at the mercy of Germany." However, "Means must therefore be found to reconcile the varying interests of European countries

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<sup>66</sup> Ibid., 552.

<sup>67</sup> State, "Foreign Relations of the United States, 1947. Council of Foreign Ministers; Germany and Austria," 215.

in the export of Ruhr coal and steel.”<sup>68</sup> Policy concerning the Ruhr followed a similar transformation to other policy over German economic prosperity. Early apprehension over German industrial power gave way to a policy that promoted both a prosperity and multilateralism, which was inclusive of Germany.

At the Moscow CFM in March 1947, Soviet Foreign Minister Vyacheslav Molotov stated his nation’s position—German economic unity and a reparations agreement were inseparable. Molotov complained that the Soviets were being excluded by the United States from forming economic ties to the Ruhr and its rightful claim to reparations. Molotov conferred that the Soviet Union was ready to account for every kopek of reparations removed from the Eastern zone and that Potsdam did not prohibit reparations from German current production. The Soviets were not willing to agree to the economic unity of Germany until quadripartite control of the Ruhr was established.<sup>69</sup> Molotov’s complaint seemed reminiscent of one that Ribbentrop and Mussolini had registered during the early stages of WWII. As an economic superpower, the United States had the power to set the rules for the global market and the ability to set boundaries, which could include or exclude other nations.

The final act of the division of Germany was the West German currency reform in June 1948. Economic recovery was impossible unless the inflationary effect of a worthless currency was replaced with a new currency issued on a bizonal basis.<sup>70</sup> The new currency was printed for the Western zones only, definitively separating the economy of the Western zones from the Eastern zones. This was a purely Western Allied

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<sup>68</sup> Ibid., 221.

<sup>69</sup> Ibid., 264.

<sup>70</sup> Clay, *Decision in Germany*, 208.

measure and was an unmistakable sign that any hope of unification was over.<sup>71</sup> By 1948, the United States had completely changed its policy and currency reform, halted reparation payments to the Soviet, and denied Soviet participation in the Ruhr, all severed to divide Germany for the purpose of the restoration of economic prosperity in the Western zones.

### A “West” German Recovery

The story of postwar Germany, at least for the Western portion, was a story of struggle at first and then recovery. In 1920, John Maynard Keynes wrote in *Economic Consequences of the Peace*, “Round Germany as a central support the rest of the European economic system grouped itself, and on the prosperity and enterprise of Germany the prosperity of the rest of the Continent mainly depended. The increasing pace of Germany gave her neighbors an outlet for their products, in exchange for which the enterprise of the German merchant supplied them with their chief requirements at a low price.”<sup>72</sup> However, in 1948, after 34 years of war and suffering, Germany’s reluctant neighbors would have to be willing to accept its return to free and independent status; Europe’s prosperity depended on it.<sup>73</sup> Besides the pressure exerted by the United States, there were other forces helping to push Germany’s acceptance into the European market.<sup>74</sup> The slow rate of recovery during the first few years of the occupation and the increasing sense of a Soviet threat helped to persuade Germany’s European neighbors

<sup>71</sup> Kramer, *West German Economy, 1945-1955*, 134.

<sup>72</sup> John Maynard Keynes, *The Economic Consequences of the Peace*, by John Maynard Keynes. (London, Macmillan, 1919), 14.

<sup>73</sup> Clay, *Decision in Germany*, xi.

<sup>74</sup> Wiesen, *West German Industry and the Challenge of the Nazi Past, 1945-1955*, 211.

that a strong and democratic West Germany under the tutelage of the United States was the best hope for a peaceful and prosperous Europe.

By 1948, two and a half years of occupation had passed, and recovery in both Germany and Europe was stalled. Germany had been divided clearing the way for the application for multilateralism among the Western Allies. A European market, which included West Germany, would now be given a chance to fulfill the expectations of recovery. A new set of State Department officials could finally take the lead and set in motion the proposals of early postwar planners, reviving Western Europe with the creation of a multilateral commercial system.

## Chapter V

### 1947–1948: An Integrated West Germany

#### Introduction

The start of the Cold War coincided with the emergence of a Western-orientated multilateral world economy. By 1947, it became clear to US officials that the German problem, the economic unity of the German nation, was not solvable, but that the European problem, rebuilding a prosperous European economy, was. The economic recovery of a united Germany was being prevented by a policy conflict between the United States and the Soviet Union, with no foreseeable solution in sight. The division of Germany into East and West was predicated by the necessity of Western powers to close off their zones from the Soviet zone to secure multilateralism and, thus, prosperity. By 1947, the nature of partition had changed. Before 1947, partition signified a division of the nation of Germany; from 1947 on, partition signified the separation of an international capitalist Western economy from Soviet controlled Eastern European economy. Multilateralism was initially intended by the US State Department to include most of the world; by 1948 they had to accept a smaller region that excluded the Soviets and Eastern Europe. The Cold War partition had implications beyond the German border, West Germany became more than just a dividing line between East and West; it developed into the centerpiece of what was to become a Western European economic engine.

George C. Marshall was sworn in as Secretary of State in January 1947. His main objective was to find a solution for the crisis in Europe. The ongoing economic stagnation of Europe was raising concerns within the US government about an advance

of communist influence on the continent. One of the first measures taken by Secretary Marshall was the creation of the Policy Planning Staff (PPS) under the direction of George F. Kennan. The purpose of the staff was to create foreign policy recommendations for the crisis in Europe. Kennan, an acknowledged Soviet expert, was directed to develop a European Recovery Program (ERP). The ERP would be a departure from the piecemeal approach to handing out aid; participants would have to organize the rehabilitation of the continent on an integrated basis. It became a turning point in US foreign policy because for the first time, the United States forcefully injected itself into European affairs during peacetime by granting large amounts of financial aid.<sup>1</sup> At Kennan's recommendation, US policy was not to be directed at combating communism, but to restore the economic health of Europe. Aid to Europe was formulated with initiatives that required economic multilateralism, not ideological preconditions; Europe was to be saved by economic collaboration and free trade. The goal of the ERP can be recognized as the aspiration of what early postwar planners at the State Department had first recommended in 1939.

The ERP was made available to all nations of Europe, including the Soviets. Marshall, along with other State Department officials questioned Kennan's recommendation allowing for Soviet participation. They were concerned that Soviet involvement would sabotage the program, but Kennan urged Marshall to play it straight and extend the offer to Stalin.<sup>2</sup> This was a difficult proposal for Marshall to accept, as the need to develop an ERP for Europe was caused by an unyielding Soviet policy in

<sup>1</sup> Wilson D. Miscamble, *George F. Kennan and the Making of American Foreign Policy, 1947-1950*, Princeton Studies in International History and Politics; (Princeton, N.J.: Princeton University Press, 1992), 50.

<sup>2</sup> Günter Bischof, "The Advent of Neo-Revisionism?," *Journal of Cold War Studies* 7, no. 1 (Winter 2005): 148, doi:10.1162/1520397053326176.

Germany to some extent. The Soviets had been acting without regard for the other occupation zones and were enforcing closed economic policies elsewhere in Eastern Europe. It was during the ERP negotiations that Soviet Foreign Minister Molotov challenged the US State Department's approach of an integrated multilateral European reconstruction program. Molotov insisted on a nation-based approach. Aid should be allocated to individual countries, without multilateral strings attached. Molotov and Stalin were not interested in free trade and knew that in an open-door competition, their country was no match for the American economic juggernaut.<sup>3</sup> The development of the ERP highlighted the friction between the United States and the Soviets over the role of Germany in European redevelopment. Were the economic resources of Germany to be used to rebuild Europe or the Soviet Union?

When it came time to negotiate over ERP funding, the Soviets were not the only nations reluctant to think beyond their own nationalist goals. In the summer of 1947, sixteen nations met in Paris to form the Committee of European Economic Co-operation (CEEC), an organization formed to make recommendations as to the nature and disbursement of ERP aid. During negotiations, it became evident that most nations were still mired in nationalism. They sought out funds with the intent of improving their position among their fellow nations. CEEC committees could not come to agreement on a European wide policy that would transcend individual nationalistic priorities.<sup>4</sup> When it came to Germany, Clay and the military were not immune from this position; they insisted that Germany should be administered as a separate and special recipient of ERP

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<sup>3</sup> Ibid., 146.

<sup>4</sup> Miscamble, *George F. Kennan and the Making of American Foreign Policy, 1947-1950*, 64.



funds.<sup>5</sup> General Clay was concerned that Germany's neighbors would design a plan that would be detrimental to the recovery of West Germany. He was correct in his assessment; the initial CEEC recommendations called for a recovery rate for Germany that was too low.<sup>6</sup> Nearly all the policy recommendations made by the sixteen CEEC members did not meet with US State Department approval and had to be reworked to fit the proposed multilateral structure.

US occupation forces were not inclined to promote multilateral policy in Germany. From the start of the occupation, Clay preferred to approach economic problems from a German as opposed to a European perspective. An increasing level of antagonism with the Soviets compounded this dilemma. Daily decisions were made on the basis of short-term results with the intention of alleviating the occupation's financial burdens. US State Department records point to disagreements over the application of funds between the military and the State Department during the first three years of the occupation. State Department documents report, "Issues which have arisen involved the rather narrow view of German interests taken by the Army Department, restricted as it is by the specific purposes for which its funds were appropriated, as against the Department of State's interest in over-all western European recovery."<sup>7</sup> As difficulties with the Soviets increased in Germany, there was concern at the State Department over the expanding influence of the War Department over foreign policy. With the focus shifting from economic to military issues, State Department planners were concerned that they

<sup>5</sup> Thomas Alan Schwartz, *America's Germany: John J. McCloy and the Federal Republic of Germany* (Cambridge, Mass.: Harvard University Press, 1991), 33.

<sup>6</sup> Alan S. Milward, *The Reconstruction of Western Europe, 1945-51* (Berkeley: University of California Press, 1984), 188.

<sup>7</sup> United States Department of State, "Foreign Relations of the United States, 1948. Germany and Austria," 1948, 1311, <http://digicoll.library.wisc.edu/cgi-bin/FRUS/FRUS>.

had little say in shaping occupation policy.<sup>8</sup> As the crisis in Berlin drew closer, it became necessary to leave Clay and the military in charge although their ideas clashed with the State Department's.<sup>9</sup> There were some positive, unintended consequences for the German economy as a result of the confrontation with the Soviets. As tensions with the Soviets increased, American military officials were able to justify accelerating industrial production in the Ruhr and other sectors in the Western zones. Eventually, Washington was able to legitimately override concerns from France and other European nations about increasing German production under the portent of a looming Soviet threat.

In January 1948, Secretary Marshall announced that the State Department was ready to take over control of the occupation in Germany. Although this had been a long-term goal of both the Army and State Departments, the timing seemed premature.<sup>10</sup> 1948 turned out to be a year of dramatic change in Germany as the Soviets were increasingly left out of policy planning made among Western European allies. February saw the start of the London Six Power Conference, which included the United States, France, Great Britain, and the Benelux countries, but excluded the Soviet Union. These talks led to the formation of West Germany. In March, the first forms of the Soviet blockade of Berlin started. In June, a separate currency reform was rolled out in the Western zones. Finally, in September, a parliamentary council assembled in Bonn to draft a constitution for a West German government. Clay, who had expected to be leaving Germany by 1948, was asked to stay because of the escalation of tensions.

The increasing potential for hostilities with the Soviets changed the nature of the so-called German problem. Starting in 1947, Germany's neighbors began to realize that

<sup>8</sup> Miscamble, *George F. Kennan and the Making of American Foreign Policy, 1947-1950*, 147.

<sup>9</sup> Milward, *The Reconstruction of Western Europe, 1945-51*, 155.

<sup>10</sup> Lucius D. Clay, *Decision in Germany* (Garden City, N.Y.: Doubleday, 1950), 239.

they might have to accept a stronger Germany as a buffer to Soviet power. Because of Germany's recent history of military aggression, Germany's neighbors were wary of accepting its return to independent status. At the end of WWII, there was a great potential for Germany to return to a position of strength, and its citizens seemed willing to make the necessary sacrifices to rebuild its industrial economy. Germany possessed a large industrial capacity that was ready to take full advantage of any spike in foreign demand. German workers were willing to contribute to the reconstruction of Germany by accepting lower wages, thereby creating higher profit levels leading to an increase in additional investment capital. The German middle-class was willing to accept a currency reform by which small holders would lose their savings while the value of the industrial capitalists remained unaffected. In the Western zones, the United States and Great Britain had been leaving industrial capital largely intact.<sup>11</sup> Conditions were different in East Germany where the Soviets had been removing large amounts of industrial capital in the form of reparations. As antagonisms with the Soviets mounted, US policy in the West increasingly promoted economic prosperity; meanwhile, Soviet policy in the East was promoting political solutions that would improve Soviet security.

The introduction of multilateralism into the European economic system through the application of ERP aid was seen by the US State Department as a necessity, even if it led to the eventual division of Germany. Kennan advised Marshall to leave the door open to the Soviets and all of Eastern Europe to participate in the program, an option that Kennan was sure Stalin would not take.<sup>12</sup> Kennan knew that a multilateral form of international commerce was inconsistent with Soviet policy. He felt strongly that the

<sup>11</sup> Henry Christopher Wallich, *Mainsprings of the German Revival*, New edition (New Haven, Conn.; Yale University Press, 1976), 12.

<sup>12</sup> Miscamble, *George F. Kennan and the Making of American Foreign Policy, 1947-1950*, 52.

Soviets would never allow multilateral interaction between East European nations and the West, and was therefore convinced that the Soviets would reject the plan.<sup>13</sup> Stalin was initially interested in negotiations for ERP aid but started to lose interest once he learned that funds would be applied on a multilateral basis. The introduction of the ERP in 1947 meant that Stalin had to make a choice, either cooperate in a multilateral free trade economy or have the eastern half of both Germany and Europe cutoff from a growing Western prosperity.

#### State Department Policy: 1947–1948

1947 brought a sense of urgency to the conditions in Germany and Europe. In May, Clayton returned from a tour of the region and was shocked by the breakdown of economic activity. All US governmental officials familiar with the conditions felt the situation called for immediate action. From the fall of 1946 through the spring of 1947, there was a critical shortage of coal during what turned out to be an exceptionally cold winter. This was compounded by a severe drought and a persistent food shortage.<sup>14</sup> With food shortages, coal shortages, and a lack of dollars to pay for imports, Western Germany and much of Western Europe was on the brink of disaster. American officials grew concerned that Europe would be vulnerable to communist influence.<sup>15</sup> In response, Truman called on the US State Department to act immediately and with substance.<sup>16</sup> The initial concept for the ERP originated in the economic section of the State Department in 1946, but it was the crisis of 1947 that brought on a sense of urgency. It was this

<sup>13</sup> Ibid., 57.

<sup>14</sup> Clay, *Decision in Germany*, 270.

<sup>15</sup> E. F. Penrose, *Economic Planning for the Peace* (Princeton: Princeton University Press, 1953), 345.

<sup>16</sup> William Diebold Jr., "The Marshall Plan in Retrospect: A Review of Recent Scholarship," *Journal of International Affairs* 41, no. 2 (Summer 1988): 435.

heightened state of concern of the Truman Administration that pressured a fiscally conservative Congress to allow the State Department to act decisively with substantial ERP funding.<sup>17</sup>

The design and implementation of the ERP was dependent on multilateral cooperation among European nations. Up until 1947, Soviet controlled Eastern Europe had not acted in this manner. Kennan, who headed the PPS found himself responsible for the articulation of American global policy, with the salvation of European capitalism as his top priority.<sup>18</sup> The PPS was immediately thrown into the ERP. Policy papers confirm that by 1948 the State Department was abandoning its policy on German unification as a necessary precondition of European recovery. Kennan had concluded that the failure to treat Germany as an economic unit was the result of the Soviet Union refusing to implement common policies with respect to foreign trade and reparation removals. Because of the ERP, the emphasis of US policy with regard to Germany had to be changed from active concentration on the achievement of economic unity to the full-scale participation of bizonal Germany in the recovery of Western Europe. Kennan called for an increase in the present levels of industrial production to double in order to meet the new requirements.<sup>19</sup> This was a decisive change in policy. Previously, the State Department was willing to forego full-scale German industrial production for the possibility of uniting Germany and the development of an egalitarian multilateral Europe. However, Kennan pointed out that the prosperity of a multilateral Europe was dependent on full-scale production in Germany and the US State Department was willing to divide Germany to achieve this goal.

<sup>17</sup> Bischof, "The Advent of Neo-Revisionism?," 149.

<sup>18</sup> State, "Foreign Relations of the United States, 1948. Germany and Austria," 1288.

<sup>19</sup> Ibid., 1309.

By 1947, there was a convergence of support among US government departments in favor of a proactive multilateral foreign policy for Western Europe, a formation in which West Germany would play a leading role.<sup>20</sup> Both the Executive and Legislative branches supported multilateral policy. Congressional support for ERP funding depended on a multilateral concept by stipulating that legislation must be framed as aid for Europe and not a series of individual countries.<sup>21</sup> The perception of a Soviet threat was a key factor in the consolidation of US support for a proactive policy. By 1948, concerns by US officials over Soviet influence in Europe helped to create a consensus, changing the tide of support away from a fiscal conservative agenda to a foreign policy based on a proactive multilateral approach to European affairs.

A central stipulation of US multilateralism was that Western European nations must accept West German integration. Not all Europeans were in agreement on the benefits of multilateral integration, especially with Germany. Considering the past thirty years of history, many Germans and their neighbors were not willing to accept the integration of the West German economy into Europe. In 1947, to many Germans, integration meant granting license to France, Belgium, and Switzerland to use German resources for their own benefit without corresponding benefits for Germany.<sup>22</sup> Most other European nations were looking for a sizable financial aid package before they would agree to open up their national economies to international competition. When the US State Department first announced the ERP, they expected Western European nations to willingly help construct a plan that would ensure West German integration. PPS policy

<sup>20</sup> Diebold Jr., "The Marshall Plan in Retrospect," 428.

<sup>21</sup> Ibid., 433.

<sup>22</sup> Charles Poor Kindleberger, *Marshall Plan Days / Charles P. Kindleberger*. (Boston: Allen & Unwin, 1987), 8.

papers addressed this issue. Kennan wrote, “Our present objective is, together with the United Kingdom and France, to reconstitute Western Germany as a political entity capable of participating in and contributing to the reconstruction of Europe in respect to economic life and the general security.”<sup>23</sup> Despite early expectations of cooperation among ERP participants, the State Department soon came to recognize that Western European nations would not willingly give up economic sovereignty.

As late as 1947, a punitive JCS1067 was still the official policy position of the United States. A new directive, JCS1779, released in July 1947, had been under consideration since the summer of 1945. From 1945 through 1947, there had been a gradual and unofficial transition of policy toward the promotion of German industrial prosperity. At the time of Byrnes’s Stuttgart speech in 1946, much of JCS1779 was already in effect.<sup>24</sup> It was likely that JCS1067 was kept in effect as a backup position until the United States had a clearer understanding of Soviet motives. A punitive policy would not be completely ruled out as long as there was a possibility of reaching an agreement with the Soviets.<sup>25</sup> The turning point for the official change in US policy came in June 1947 when the Soviet Foreign Minister, Vjaceslav Molotov, walked out on the Paris ERP negotiations. The United States and its Western allies then started to coordinate an economic recovery without concern for the Soviet Union. Finally, in July 1947, with the release of JCS1779, the unofficial policy of restoring the German economy became official.

<sup>23</sup> State, “Foreign Relations of the United States, 1948. Germany and Austria,” 1298.

<sup>24</sup> Clay, *Decision in Germany*, 238.

<sup>25</sup> Bruce Kuklick, *American Policy and the Division of Germany; the Clash with Russia over Reparations*. (Ithaca NYCornell University Press 1972, 1972), 198.

The ERP was the centerpiece of US postwar planning; its main goal was identical to what early planners had in mind, an integrated system of trade liberalization. State Department documents from 1948 assert “It is US policy that the fullest possible recognition be given this interdependence in order to achieve the greatest over-all benefits for the European Recovery Program.”<sup>26</sup> For a variety of reasons, West Germany was to play a central role in the implementation of this program. It had the industrial potential to be the driving force behind European economic growth, it could be directly influenced by the presence of US troops, and its economic development could be directed by the US State Department.<sup>27</sup> American funds were critical to restarting West Germany commercial trade; from 1945–1948, the United States financed 66 percent of all German imports, and 39 percent in 1949. This was important because, at the time, Germany did not have the currency reserves to purchase the raw materials needed to restart its equipment manufacturing industry.<sup>28</sup> The reduction of trade barriers alone would not restore a commercial system. Most economists at the State Department prescribed two other ingredients: full employment and the application of ERP aid for a period of three to four years.<sup>29</sup> The main problem was that after the war, most nations had a poor balance of payments, (i.e., they had little in currency reserves from which to pay for imports). ERP funds were intended to bridge this gap by providing a much needed dollar reserve to be used for international trade.

To further enhance commercial trade, in July 1945, the United States and its allies formed the International Trade Organization (ITO), with the goal of releasing

<sup>26</sup> State, “Foreign Relations of the United States, 1948. Germany and Austria,” 1310.

<sup>27</sup> Alan Kramer, *West German Economy, 1945-1955*, First Edition (Oxford: Berg Publishers, 1991), 161.

<sup>28</sup> Milward, *The Reconstruction of Western Europe, 1945-51*, 99.

<sup>29</sup> Bruce Kuklick, *American Policy and the Division of Germany; the Clash with Russia over Reparations*. (Ithaca NY Cornell University Press 1972, 1972), 350.



international commerce from the restraints of protectionism and tariff barriers. The State Department was determined to gain West German inclusion in these international trade organizations. State Department policy papers from 1948 recommended that the United States sponsor German membership in the ITO and its successor organization General Agreements on Tariffs and Trade (GATT). These efforts initially failed, but the State Department was successful in gaining most-favored-nation treatment for Germany from other ERP members as a condition of their participation. In the meantime, the United States was conducting trade with Germany in a manner that was in full accord with ITO policies.<sup>30</sup>

Disagreement between the United States and the Soviet Union over the economic development of Germany helped ignite the start of the Cold War. From 1945 to 1947, policy toward Germany was still punitive in nature and did not seek partition. Even as late as 1948, some State department officials, including Kennan, still held out some hope for unification. The failure by this late date to produce a four-power agreement caused the United States to reverse its policy stand.<sup>31</sup> State Department policy papers from 1948 illustrate that the members of the PPS placed blame on the Soviet Union, stating, “It was made clear that the price to be extracted of the Western powers for an agreed solution of the German problem was Soviet-Communist control over the economic and political life of all of Germany.”<sup>32</sup> The inability to resolve this issue came to a head at the CFM meeting held in London on December 1947, as an agreement was still out of reach. From this point on, US policy was to pursue the division of Western German from the East

<sup>30</sup> “FRUS: Foreign Relations of the United States, 1946. Council of Foreign Ministers: Contents,” 1312, <http://digicoll.library.wisc.edu/cgi-bin/FRUS/FRUS>.

<sup>31</sup> Miscamble, *George F. Kennan and the Making of American Foreign Policy, 1947-1950*, 142.

<sup>32</sup> “FRUS: Foreign Relations of the United States, 1946. Council of Foreign Ministers: Contents,” 1300.

with an emphasis on the development of a strong and independent West German state. Officially, the United States had not given up hope of renewed four-power discussions in the future, nor did it completely abandon hope for unification; however, the present situation in Germany called for urgent solutions to economic and political problems.<sup>33</sup> The United States government would no longer wait for an agreement to restore healthy economic conditions in Germany.

By the summer of 1948, the new goal of the United States was to ensure that a soon-to-be constituted West German state make a vital contribution to the economic rehabilitation and political stability of Europe. Western Germany had to gain the acceptance of the United Kingdom and France as a prerequisite before its integration into a Western European economic system. The shared use of German resources for the purpose of creating a Western European prosperity was a critical inducement for West German acceptance.<sup>34</sup> From February through June of 1948, a Six-Power Conference was held in London, specifically addressing the creation of the new West Germany state. These talks included the United States, United Kingdom, France, and the Benelux countries. The tone of the conference was set by a communiqué released in March 1948 and recommended that to confirm the availability of coal, coke, and steel to all of Western Europe, it had been decided that there must be a close association between all economies involved in the ERP. The Ruhr must not be separated from Germany, but an agency, the International Authority for the Ruhr (IAR), must be created by the Six-

<sup>33</sup> Dean G. Acheson, in, United States Dept of State Office of Public Affairs, *Germany, 1947-1949: The Story in Documents Prepared by Velma Hastings Cassidy, of the Division of Historical Policy Research, Office of Public ... of the Bureau of German Affairs* (University of Michigan Library, 1950), 20.

<sup>34</sup> State, "Foreign Relations of the United States, 1948. Germany and Austria," 1298.

Powers to control distribution and production of the Ruhr resources.<sup>35</sup> This agency would not include the Soviets, and thus a major obstacle in negotiations had been removed.

Control of the Ruhr could now be made within the confines of West European considerations. By the exclusion of the Soviets, it was anticipated that agreements over the distribution of resources from the Ruhr region would be easier to attain.

A new West German state combining the US, British, and French zones linked to US multilateral policy objectives was taking shape. Under the recommendations of Kennan and the PPS, the Western portion of Germany was removed from an ineffective quadripartite control and was reconstituted as an independent nation back in pursuit of economic prosperity closely aligned with the Western powers. PPS documents advised that West German independence could only be accomplished by a complete withdrawal from the Allied Control Council (ACC); therefore, the best policy path would be to proceed with vigorous implementation of the London Conference recommendations.<sup>36</sup> This new policy would directly undermine the authority of the ACC. On March 20, 1948, the last ACC meeting was held and the Soviet representative, Vasily Sokolovsky, walked out.<sup>37</sup> This abrupt end to the ACC was due to Soviet resentment over their exclusion from having any say in the distribution of resources from the Ruhr. The ACC was finished, both the United States and the Soviet Union had undermined quadripartite control, and the division of Germany was final.

No policy had done more to finalize the division of Germany than the implementation in June of 1948 of a separate currency for West Germany; perhaps no policy has been given more credit for German economic recovery than that same

<sup>35</sup> London Six Power Conference Communiqué, in *Germany, 1947-1949*, 76.

<sup>36</sup> State, "Foreign Relations of the United States, 1948. Germany and Austria," 1298.

<sup>37</sup> Clay, *Decision in Germany*, 356.

currency reform. Reconstruction took off after currency reform; it is often referred to as “day one” of the new Germany.<sup>38</sup> The new Deutschemark was not the origin of German recovery, but it was a necessary prerequisite, a critical measure allowing a slow recovery to gain momentum.<sup>39</sup> The new functioning currency brought stability to the market place. Shop owners could confidently stock their shelves, and industrial capitalists could accurately calculate profits and make stable investment decisions. The psychological impact of the currency reform combined with the knowledge of German participation in the ERP added to a growing confidence in recovery.

The US State Department had been eager to create the new currency since 1946, but it had to wait for the right time. Being in a powerful position as an occupier, it was easier for the United States to enforce a new currency than for a democratically elected German parliament. The opportunity presented itself in June 1948, immediately after the breakup of the ACC. Without Soviet interference; the remaining Western allies had no difficulty in agreeing on the terms. Initially, each German could exchange, on a one-to-one basis, sixty old Reichsmarks for sixty new Deutschemarks. Subsequent exchanges of old currency for Deutschemarks was limited to 100 to 6.5, eliminating 93.5% of old currency.<sup>40</sup> Many middle income Germans with money in the bank found that their previous savings had been drained and replaced with a smaller starting amount of the new currency. Industrialist's had a strong financial incentive to support currency reform. It

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<sup>38</sup> S. Jonathan Wiesen, *West German Industry and the Challenge of the Nazi Past, 1945-1955*, New edition (Chapel Hill, N.C.: The University of North Carolina Press, 2004), 95.

<sup>39</sup> Kramer, *West German Economy, 1945-1955*, 173.

<sup>40</sup> Clay, *Decision in Germany*, 213.

heavily favored capital owners whose fixed capital assets were unaffected by the conversion.<sup>41</sup>

With the onset of the Soviet blockade in the summer of 1948, Berlin became the symbolic focal point in what was to become the Cold War. In the spring of that year, Clay had expressed his confidence to Secretary Marshall that as long as the United States held its ground, he had no fear of military aggression by Soviet forces and that Communism had lost its opportunity to capture Germany.<sup>42</sup> In the opinions of the United States and other Western powers, Berlin had become a symbol of firmness from which no retreat was possible. The London Agreements and the Blockade of Berlin helped to create a new image for West Germany, one of integrity, a nation of freedom loving people holding the front lines against the Soviet aggressors. Despite the new image, the series of events and failed negotiations that separated East Germany from West Germany did not come about as an internal dynamic or a choice made by the German people. A separate West German nation with a separate economic recovery fully integrated onto a multilateral Western block of nations was an external process decided on by its occupiers, particularly the US State Department. The roots of this external process can be traced back to policy generated in 1939 by early postwar planners at the US State Department.

#### The European Recovery Program and West Germany

Through the influence of ERP funds, the United States was able to compel the European market into the use of a multilateral commercial system. One main precondition was that West Germany was to be included. There has been a significant debate among historians regarding the value of ERP aid to the European recovery. The

<sup>41</sup> Wiesen, *West German Industry and the Challenge of the Nazi Past, 1945-1955*, 95.

<sup>42</sup> Clay, *Decision in Germany*, 376.

inquiry centers on whether internal European trade networks or the external influence and aid provided by the United States generated economic recovery. The debate often focuses on who benefited from the aid; the impact of ERP aid was not recognized equally by all participating nations. Most historians would agree that it was more important to the recovery of West Germany than to most other European nations. As the dominant occupier, the United States had direct influence on the West German economy and could direct its interactions. Whereas it can be debated as to what degree the recovery of individual European nations was enhanced by the efforts of the United States, the application of US aid by use of a multilateral approach was critical to the creation of an interdependent structure of international commerce in Europe and was decisive to the inclusion of West Germany.

Before the successful return of West German commercial trade to the international stage, the concerns of other nations had to be addressed. To a great extent, the perception of a Soviet threat from Eastern Europe went a long way in allowing West German integration into West European international markets. However, the application of ERP funds as leverage by the United States was also important in promoting the return of West Germany. For example, on three different occasions in 1948, European nations were asked to give both West Germany and Japan most-favored-nation trade status as a condition of receiving ERP funds.<sup>43</sup> This request encountered considerable resistance from French and British Foreign Service officials and Western European domestic labor organizations. The United States was eventually able to convince European nations to concede to most-favored-nation trade status for West Germany, but not for Japan.<sup>44</sup> Any

<sup>43</sup> Milward, *The Reconstruction of Western Europe, 1945-51*, 114.

<sup>44</sup> *Ibid.*, 120.

major industrial economy, like Germany or Japan, even though they had been recent enemies, would be an important contributor to a global marketplace.

In the immediate postwar period, most European nations intended on paying for the reconstruction of their economies by increasing their exports. The US State Department recognized that a shortage of available foreign currency in Europe would derail these plans. The value of postwar foreign trade varied from nation to nation. In 1949, the trade/ per-capita as a percentage of national income was in 71.3% Belgium, 30.3% in France, and 39.4% in Britain.<sup>45</sup> Nations like France and Britain could conceivably establish their own national economies first and later negotiate a more beneficial trade deal. Other European nations like Germany, Belgium, and the Netherlands were in an immediate need to reestablish a trade network. Perhaps the most significant aspect of the ERP was the financial capability given to West German allowing it to participate in the international commercial market.<sup>46</sup> In mid-1949, the Organization for European Economic Co-operation (OEEC), the successor organization to the CEEC, was set up by seventeen nations to allocate ERP funds and administer policy decisions. They immediately began to promote trade deals and make tariff reductions that affected 50% of all European trade. However, the solution to the problem involved more than just reducing tariffs. Before full implementation of tariff restrictions could occur, nations had to resolve their balance of payments problems. With so many countries looking to dramatically increase exports, there was no viable mechanism by which international payment settlements could be balanced other than returning to highly restrictive bilateral trade agreements. The Bretton Woods Agreement of 1944 addressed this issue, but its

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<sup>45</sup> Ibid., 213.

<sup>46</sup> Kramer, *West German Economy, 1945-1955*, 154.

scope was too small to fix the problem. Large balance of payment discrepancies persisted through the end of the decade. ERP funds proved to be crucial. By providing currency in the form of dollars necessary to pay for imports, the United States helped generate a multilateral trade in the seventeen participants as a whole.<sup>47</sup> This environment of expanding exports helped to create prosperity among the participating nations and pushed ERP participants to eventually develop a model of European economic integration similar to what had been proposed by early postwar planners at the US State Department.

The forceful position of the United States as a sponsor was a key component of West Germany reacceptance to the community of nations. This process was facilitated in a number of ways. The United States insisting that West Germany become a member of the OEEC was a factor in creating the preconditions that allowed Germany's return to the world economy.<sup>48</sup> West Germany's neighbors had concerns about a powerful and independent West Germany eventually dominating the market.<sup>49</sup> To resolve these objections, the US State Department was successful in formulating a policy by which the recourses from the Ruhr could be used as a basis for an exchange of trade that would benefit other Western nations. The United States also solved other problems that could have hindered the acceptance of a West Germany state by its European neighbors. The ERP resolved the reparations problem for Western Europe by providing a financial alternative to receiving German reparation payments. The United States provided the political framework for West Germany to develop as a stable democratic state. Perhaps most importantly, the combined effect of these factors led to the removal of economic uncertainty. West German participation under the direct supervision of the United States

<sup>47</sup> Milward, *The Reconstruction of Western Europe, 1945-51*, 210.

<sup>48</sup> Kramer, *West German Economy, 1945-1955*, 162.

<sup>49</sup> Milward, *The Reconstruction of Western Europe, 1945-51*, 189.



led to political, economic, and military stability; the value of these conditions to the development of an international commercial system cannot be underestimated. By securing the division of Germany, the United States was successful in creating a West German safe zone suitable for its inclusion in a multilateral commercial system that was closely tied to Western capitalist ideals. A secure and capitalist West Germany was a better outcome than the uncertainty of never-ending negotiations with the Soviets over a united Germany. The US State Department policy set the stage for a powerful industrial nation centrally located on the European continent to fully participate in a future capitalist world market without concerns for past German notions, like lebensraum, autarchy, or beggar-thy-neighbor policies, or new concerns over communist infiltration. From this point forward, a powerful German industrial economy could be safely reconnected within the European community of nations with the purpose of producing international prosperity.

The application of the ERP to the particular region of Europe was important. Europe, unlike other parts of the world, was capable of sustaining a higher level of multilateral exchange and had a long history of industrial production.<sup>50</sup> The United States was not interested in a New Deal program for the world, but aid given to redevelop Europe would pay off in the long run for the US economy. The industrial nature of both the European and American economies meant that both of their fates were tied together. In a speech given in 1947, Marshall expressed his ideas about a special connection between the United States and Europe. The United States does not want to fill the European vacuum with American, Soviet, or even German power. Europe must be a community of nations, not dominated by a single power. It is the divergence of interest

<sup>50</sup> Miscamble, *George F. Kennan and the Making of American Foreign Policy, 1947-1950*, 61.

over the condition of Europe that causes the difference between the Soviets and the United States. Marshall clearly defined the Soviets as an opponent of economic recovery while the United States was promoting prosperity.<sup>51</sup> Marshall went on about the important position of Europe. The enlightened interests of the United States coincides with the best interests of Europe. Europe is an advance civilization of which the United States is a part; the United States' national traditions have their foundation in Europe. The USSR does not share this purpose; if the USSR prevails, a prosperous Europe cannot be reestablished. Marshall states, "The logic of history would appear to dictate the necessity of this community, drawing closer together not only for its own survival, but for the stability, prosperity, and peace of the entire world."<sup>52</sup>

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<sup>51</sup> George C. Marshall, in, *Germany, 1947-1949*, 11.

<sup>52</sup> *Ibid.*, 9.

## Conclusion

The West German economy came to thrive in the post-WWII era. By 1950, West Germany had returned to the world market with a vengeance. The 1945 to 1950 period of transformation coincided with the full force of the US occupation and was marked by a number of dramatic changes to the organization of both the German and European economies. These changes were initiated by a policy in which its roots can be traced back to the early postwar planning done in 1939 by US State Department officials and their partners at the Council of Foreign Relations. The United States contributed to the establishment of a European wide system of prosperity based on a multilateral trade that included the West German industrial economy as a central player. This course of events went against the natural impulse of nations to reintroduce economic nationalism in the postwar period. During the first half of the twentieth century, Europe became increasingly nationalistic. During the post-WWII occupation period, this trend was starting to reverse. To encourage economic prosperity, the United States expected European nations to surrender a portion of their economic sovereignty for all trading partners to benefit from a mutual prosperity with the expectation that this would lead to peace.

There were other dramatic changes that occurred during the occupational period that can be attributed to US foreign policy to some extent. In 1948, Germany transitioned from a planned economy to a liberal economy. Germany, more than any other industrial nation, had a history of planned economies. Germany's; the nation's natural bent toward order and organization predisposed Germany in favor of control. In 1948, the choice to change course was not without significance. The transition to free markets was not

completed in 1948, but the general trend was established. US policy deserves considerable credit for Germany taking the first steps toward market liberalization, a trend that was gradually accepted and eventually intensified by German industry.

The United States played a major role in the division of Germany. As a result, the United States can accept credit for advancing the economic prosperity in Western Europe, but the burden of the Cold War animosity fell heavy on both the European continent and the US taxpayer. It is ironic that US State Department officials who were the most opposed to partition before 1947 were, in the end, the officials most responsible for the division of Germany. There is a remote possibility that full cooperation with the Soviets from the start of the occupation might have unified Germany, but the State Department would have had to give up on its multilateral doctrine. A postwar international commercial system of trade under a Soviet dominated Europe would not have been much better than an international trading system under a German fascist dominated Europe.

West Germany became an essential part of European economic success. The international free trade order pursued by the United States in the postwar period benefited a German industrial base whose potential productive capacity was ready to restart. As an exporter of producer goods, it stood to gain from a freer international movement of capital goods. As a by-product of economic recovery came the possibility of a remade culture image through the representation of a powerful German entrepreneurial economy, West Germans could put aside the shadows of the recent past to develop a new cultural image based on economic success and prosperity, a national redemption embodied in a new commercial spirit. This was at the heart of what early postwar planners at the US

State Department had envisaged—a change in the German psyche based on using an economic process to effect cultural change and to produce a wholesome democratic psychology that would be compatible with the American notion of international commerce.

There is no doubt that there was a dramatic change in attitude of the United States during the post-WWII period toward an increased involvement in international affairs. The United States reversed its prewar isolationism and advanced a proactive foreign policy. It now seems clear that US isolationism during the interwar period was detrimental to peace and prosperity of the world and that US leadership during the postwar era was both beneficial and stabilizing. Most historians recognize this change in attitude, but still debate to what extent US foreign policy can claim responsibility for the return of European prosperity. There was no question in the mind of Clay and nearly all US officials present during the occupation that the ERP saved the free nations of Europe. Still, historians like Alan Milward argue that US policy like the ERP and Bretton Woods Agreements had little effect on European economic recovery. Whether the ERP or the Bretton Woods Agreements were individually successful in lifting the economies of individual European nations misses the point. During the post-1945 period, the United States, the world's most powerful economic engine, became fully engaged in the promotion of a multilateral European prosperity. Whether a particular program or agreement succeeded in the recovery of an individual country pales in respect to the overall success of US foreign policy to partner with a grouping of European nations to create a functional international commercial market.

In 1947, the multilateral economic system proposed by the early postwar planners at the US State Department was confronting an increasingly antagonistic Soviet force in Germany. The solution of this dilemma became a defining moment in the start of the Cold War. The only viable option for the United States was to separate a multilateral West Germany from a Soviet dominated East Germany. This division ensured that a group of Western capitalist nations could rebuild a prosperous international economy through economic cooperation. The Marxist theory of imperialism contends that capitalist nations will continually start wars with other capitalists over the expanding forces of imperialism. Stalin believed that this was a root cause of WWII and that it was just a matter of time before capitalist nations would once again start an international conflict. Officials at the US State Department had a different outlook for the possibility of cooperation among capitalist nations. They believed that capitalist nations could cooperate to generate prosperity under the guise of free trade and market liberalization. A close examination of the post-WWII Europe makes it clear that under an environment of international cooperation capitalist, nations can work together to create international economic prosperity.

What became of postwar West Germany was considered by most to be a remarkable success—the growth of a powerful and prosperous economy, a stable democracy, an integrated part of a larger European market, and a proponent for world peace and security. The long-term planning and diplomatic efforts made by the US State Department to include postwar Germany in an egalitarian multilateral international market must be considered as a key factor in this outcome.

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