Marshall Plan Days

Originally published in 1987 to commemorate the 40th anniversary of the Marshall Plan, this fascinating collection of essays, from an eminent ‘insider’ to the Marshall Plan, combines economics, politics and history to provide authoritative and personal insights into the creation of one of the greatest foreign aid programmes of the twentieth century.

Any reader interested in the Marshall Plan itself, the inner workings of a major act of US foreign policy, and its many economic, political and historical facets will welcome the reissue of this valuable book from one of America’s most distinguished economists.
Marshall Plan Days

Charles P. Kindleberger
Marshall Plan Days
The Council of Foreign Ministers: Marshall, Bidault, Bevin and Molotov—meet in Moscow in March 1947. The top of the author’s head is visible in the upper right-hand corner (marked by arrow). *(The Bettmann Archive)*
# Contents

Preface  

<table>
<thead>
<tr>
<th>Year</th>
<th>Title</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>1947</td>
<td>Excerpts from the Cleveland-Moore-Kindleberger Memorandum of 12 June 1947, on a European Recovery Program</td>
<td>1</td>
</tr>
<tr>
<td>1948</td>
<td>Memorandum for the Files: Origins of the Marshall Plan</td>
<td>19</td>
</tr>
<tr>
<td>1949</td>
<td>Germany and the Economic Recovery of Europe</td>
<td>26</td>
</tr>
<tr>
<td>1951</td>
<td>European Economic Integration</td>
<td>36</td>
</tr>
<tr>
<td>1953</td>
<td>The European Recovery Program</td>
<td>51</td>
</tr>
<tr>
<td>1968</td>
<td>The Marshall Plan and the Cold War</td>
<td>72</td>
</tr>
<tr>
<td>1973</td>
<td>An Excerpt from an Oral History, Truman Library</td>
<td>83</td>
</tr>
<tr>
<td>1978</td>
<td>The OECD and the Third World</td>
<td>94</td>
</tr>
<tr>
<td>1978</td>
<td>Machlup on Integration</td>
<td>110</td>
</tr>
<tr>
<td>1984</td>
<td>The American Origins of the Marshall Plan: A View from the State Department</td>
<td>120</td>
</tr>
<tr>
<td>1987</td>
<td>Finnish War Reparations</td>
<td>167</td>
</tr>
<tr>
<td>1987</td>
<td>Belgium after World War II: An Experiment in Supply-side Economics</td>
<td>184</td>
</tr>
<tr>
<td>1987</td>
<td>Did Dollars Save the World?</td>
<td>197</td>
</tr>
<tr>
<td></td>
<td>Index</td>
<td>214</td>
</tr>
</tbody>
</table>
This is a collection of papers on the formative days of the Marshall Plan in the Department of State in 1947 and 1948 from the vantage point of one who worked on the administration's presentation to the Congress of the enabling legislation. The papers have been written over forty years, starting with one or two produced contemporaneously or immediately following the enactment of the Economic Cooperation Act of 1948, and ending with a recent batch looking back with the advantage of hindsight, perhaps in self-justification. In addition to those from close up—the viewpoint of a bureaucrat working on the economic estimates—a few back off and take an overall view on the Marshall Plan as a whole—notably Chapter 5—and somewhat tangentially on European economic integration—Chapters 4 and 9.

The essays are presented in the order of writing, though not always of publication. Chapter 1 is a series of excerpts that I think were written by me, though I cannot be certain, from a paper initiated by Harold van Buren Cleveland and Ben T. Moore, also of the economic staff of the Department of State, to which I was invited to contribute. This was finished in May 1947 before Secretary of State George C. Marshall's speech at the Harvard commencement on 5 June 1947, but delayed in typing so that its date—added in ink on the copy I acquired—is 12 June 1947. The last two essays were written to honor friends associated with those stirring times that retired and were presented at conferences in May 1986. In effect, there are two clumps of papers, one written on or shortly after the action—a batch of five—and another from the last decade, with only two papers in the intervening stretch of twenty-five years from 1953 to 1977.

The level of autobiographical content may be objectionably high. This is especially true of Chapter 2, written primarily for occupational therapy and to amuse myself; of the oral history of Chapter 7; and with Chapter 11, based on collections of my letters from 1945, 1946 and 1947, which has a note obligato of my defense against McCarthy-type attacks.

The emphasis on the role of Germany in European economic recovery may strike some readers as disproportionately large. This is because I started in the State Department working on Germany. Beginning in June 1945, I was the Washington backstop of the economists on the United States delegation to the Berlin Conference of the Three Heads of Government of the USSR, the USA, and the UK, more generally known as the Potsdam Conference, that ran from 17 July to 2 August 1945. Work on German economic problems continued through the late summer until I managed to get transferred to the office working on the British loan. Later in the fall, in November if I remember correctly, I went back to work on German questions under pressure from my superiors. Chapter 1, consisting of my contributions to the Cleveland-Moore paper on Europe relating to Germany, was the thin end of the wedge that finally got me away from German questions altogether into the far more agreeable work on Europe as a whole. This lasted until I left government for academic life in July 1948.
I have a son who works in city planning in a city that has lots of problems. Going through his briefcase in the evening on a visit—with permission—I was impressed by how much he had to think about and decide, on close questions that affect human beings for good or ill. The pressure on him is enormous. But it is good for a young man to be tested to somewhere close to his limit. Not, however, for years on end.

Each essay is preceded by a short introduction giving something by way of background.

Lincoln Center, Massachusetts
June 1986
Chapter 1 consists of excerpts from a memorandum written in the economic side of the Department of State in May 1947—though dated 12 June 1947, one week after Secretary of State George C. Marshall’s speech at Harvard University because of typing delays—by Harold van B.Cleveland of the Division of Investment and Economic Development, Ben T.Moore of the Division of Commercial Policy, and me, who was in the Division of German and Austrian Economic Affairs. The copy I have been able to get hold of lacks a title-page, and a title. The Introduction states that it was “prepared primarily for the consideration of the Policy Planning Staff, [but] it is hoped that it will evoke general discussion and criticism in the Department.”

As noted in Chapter 10 below, the memorandum was initiated by Cleveland and Moore, and I was asked to contribute only because of the importance of Germany to a European recovery effort. Cleveland and Moore had been working on European recovery in general, as opposed to the problems of separate countries, especially as major contributors to a State-War-Navy Coordinating Committee report sought by the secretaries of the three departments in March 1947. The SWNCC (pronounced Swink) report was dated 21 April, shortly before the Secretary of State and the rest of his delegation, including me, returned from seven weeks in Moscow, trying unsuccessfully, along with the British and French foreign ministers, to negotiate with the Soviet Union over German economic and political problems. The State Department’s Foreign Relations of the United States, 1947 (FRUS), Vol. 3: The British Commonwealth, Europe reproduces a series of documents prepared not only by SWNCC as noted, but also by the Policy Planning Staff headed by George F.Kennan, and by the Undersecretary of State for Economic Affairs, William L.Clayton, all prior to the Harvard speech which is also reproduced. It does not take much literary critical ability to identify the separate paragraphs of that speech that come mainly from the pens of Kennan, on the one hand, and Clayton on the other.

The Cleveland-Moore-Kindleberger memorandum was referred to in FRUS, 1947, Vol. 3, but not printed. I failed to find a copy in my own files or in the National Archives in Washington in a brief foray there, but ultimately obtained one from the Truman Library at Independence, Missouri, after learning from Professor Imanuel Wexler of the University of Connecticut that there was a copy in the papers of Joseph M.Jones, Jr, Box 2.
Since the memorandum lacks a title-page and FRUS in referring to it fails to give it a title, I have had to make up one. Authorship, however, is provided, in the absence of a title-page, by giving the names and departmental designations at the end, on page 86. The non-alphabetical order shows me to be the junior author.

The memorandum is far too long, political, bureaucratically written and redundant to merit reproduction in toto. Before I reread it, I had been mildly irritated with the Historical Office of the State Department for omitting it from the document collection—no longer. Reproduced as Chapter 1 are the table of contents and those passages referring to the economy of Germany that I may have written, though I cannot be sure. The passage on Germany under IV B(2) in the table of contents on politics is the only one I know I wrote, since I retained a copy of the passage. It was, of course, illicit for an economist to write on political questions.

The memorandum has been referred to in a number of books—for example, Jones (1955, p. 243), Beloff (1963, pp. 14–15), Wexler (1983, p. 299)—so that there may be some merit in providing a breathless world some taste of it, if only the passages that I may have written. It helps make the point underlined in Chapter 2 that many minds were working on European recovery programs during the spring of 1947. If only we had not written at such length and/or the typing had been expeditious, we would have had a better claim to immortality by having the paper dated before, rather than after, 5 June 1947.

References
Beloff, Max (1963), The United States and the Unity of Europe (Washington, DC: The Brookings Institution).

Table of Contents [of Memorandum]

<table>
<thead>
<tr>
<th></th>
<th>Page*</th>
</tr>
</thead>
<tbody>
<tr>
<td>I</td>
<td>Introduction</td>
</tr>
<tr>
<td>II</td>
<td>Summary</td>
</tr>
<tr>
<td>(part)†</td>
<td></td>
</tr>
<tr>
<td>III</td>
<td>Objectives and Premises of a United States Program for Europe</td>
</tr>
<tr>
<td>A</td>
<td>Premises and Long-Run Objectives</td>
</tr>
<tr>
<td>B</td>
<td>Short-run Objectives</td>
</tr>
<tr>
<td>IV</td>
<td>The Program</td>
</tr>
</tbody>
</table>
A European Recovery Program

II Summary

(3) United States Economic Policy in Germany [pp. 13 ff. of original memorandum]

United States economic policy in Western Germany will be of critical importance to the success or failure of the European Recovery Plan. Unfortunately our economic policy in Germany to date has neither been consistent nor has it taken adequately into account the functional relationship of Western Germany to the European economy. As regards its consistency, United States German policy originally was based upon a severely restricted premise under which the Germans were to be economically disarmed and left to their own devices for recovery. The economic disarmament aspect of this policy fitted into the broader objective of reaching agreement with the USSR in Germany where Soviet policy was harshly restrictive. Following failure to achieve agreement with the USSR on the basis of a restricted Germany, an attempt has been made to coax the Soviet Union into economic collaboration through the promotion of economic recovery. With respect to the relationship of Germany to Europe, there has been a shift from the original aim of restricting German economic activities whatever the cost to the rest of Europe toward that of creating a self-supporting bizonal area in three years (to relieve the United States taxpayer), again, whatever the cost to Europe.

At the moment United States economic policy in Germany is in a state of flux. As interpreted by the American authorities in charge of the occupation, the primary tasks are to create a self-supporting economy, achieve agreement with the USSR, and to promote free enterprise at the expense of socialism. In Washington, on the other hand, importance is attached to creating a self-supporting economy and to reaching agreement with the Soviet
Union, but emphasis is additionally placed upon promoting German recovery in the context of a European-wide recovery. The attempt to impose American economic institutions on Germany is not regarded as fruitful. The task of obtaining agreement between United States government policy as laid down in Washington and as practised in Germany is a major precondition for success in producing recovery in Germany.

The current economic situation in Germany is characterized by low levels of production, almost complete lack of control of distribution, and administrative machinery inadequate to the accomplishment of United States aims in the planning of production and foreign trade. Production of coal in the Ruhr, which had recovered from 185,000 tons a day to 238,000 tons a day in March 1947, has again been set back by a crisis in food. This food crisis took effect first in the Ruhr despite agreement in principle that the miners’ rations should be isolated from the effects of food shortage. Production of food was held back by low production of fertilizer which can be increased only with increased amounts of coal. Programming of exports, except of a few commodities such as coal, lumber, hops, etc., has been put on a private enterprise basis with the result that resources cannot be directed into productive channels necessary for Europe.

Primary requirements of the present situation in Germany are programs (1) to increase the production of coal and food; (2) to allocate coal and food internally in Germany in the most effective fashion; and (3) for production of exports which will take into account to the maximum extent possible the recovery needs of the European economy within the framework of the European Recovery Plan. In the pursuit of all these objectives, adequate administrative machinery, whether German or Allied, is needed to prevent individual businessmen, workers and farmers from refusing to produce or from diverting production into wasteful channels.

Sufficient financing must be available to provide Germany with the maximum amount of food which can be obtained in world markets up to the 2,600 calories provided for in Allied planning. The present normal consumer’s ration of 1,550 calories per day, which has not been met, is inadequate. The short-run ration goal of 1,800 calories for the normal consumer, which cannot be met during the present crop year, is the immediate aim. Other financing of German imports should be restricted to the necessary raw materials to produce exports and the minimum consumers incentive goods necessary particularly for miners and farmers. It is not considered desirable to import goods for general consumers in Germany or for capital investment until clear needs which cannot be met from German resources have been revealed. Finally, adequate financing via the ECE clearing agency mentioned above of European purchases of German goods should be made available to remove the present obstacle of the dollar requirement in the way of German exports to Europe.

IV The Program

B Political Goals and Leadership

(2) Germany [pp. 35 ff. of original memorandum]

The problem of setting political goals and stimulating effective non-communist leadership in Germany is broadly analogous to that in France and Italy. It is, however, complicated by two major factors: first, that there is no German government; and second, that there have
already developed certain mutually contradictory patterns of American and British behavior in Western Germany in relation to local political developments. A third factor which in some respects complicates the problem but in others makes it easier of solution is the fact that Eastern Germany is occupied by Soviet forces which furnish both competition and contrast to Anglo-American performance in Western Germany.

The necessity of creating German administrative organs in the bizonal area without a German government increases the difficulty of developing political effective leadership in Germany in two respects. On the one hand, the occupying forces encounter difficulty in securing the cooperation of German leadership because of the reluctance of local leaders to serve foreign powers. On the other, the responsibility for creating adequate administrative machinery is laid squarely at the door of military government and cannot be shifted to the German people.

Disparate development in political structures in the British and American zones is an equally important obstacle to development of effective non-communist leadership. In the American zone, military government has, partly through ineptness, directed its appeal to the conservative and separatist sentiments in Southern Germany. It has offered Germany the typically American slogans of free enterprise, small-scale business, frequent elections, etc. which are to a considerable extent irrelevant to the immediate needs of the population, and has exhibited hesitancy and fear if not outright opposition to trade unions, public ownership, anti-fascist popular fronts, and similar socialist-type symbols and policies. It has transferred responsibility for government to Germans in large doses—perhaps at a faster rate than the Germans have been able to take it on. And it has not always accompanied this responsibility with the grant of commensurate executive powers. Despite directives from Washington instructing the Office of Military Government to refrain from interfering in German political matters, the background of personnel at all levels of the occupation in Germany has been such that interference has taken place after the transfer of responsibility and has supported the more conservative elements in the community.

In the British Zone, on the other hand, military government has openly interfered in German politics. This interference has, however, been contradictory in character. British policy statements have supported socialism in Germany with Germans in control; at the same time the zone of occupation has been unofficially used to protect British investments and to find an inordinate number of jobs for British civil servants, thus withholding responsibility from the Germans. The differences in British and American policy in the separate zones have recently been strikingly revealed in negotiations required to constitute the bizonal administration.

The fact of Soviet occupation of Eastern Germany has made competition among the occupying powers for the favor of the German population more acute in economic matters such as employment, standard of living and food rations. Other competition is revealed in intellectual and cultural fields where Soviet policies in Germany are even more striking than those of the American and British. The Soviet Union has sought a “friendly” government in Eastern Germany (i.e., a government subject to control). At the same time it has been anxious to obtain maximum reparations from Germany, in capital equipment and in current production. Had it not been for Soviet unlimited demands for reparation, our comparative success in keeping German thought in Germany oriented toward Western Europe would have been far less.
The development of an adequate indigenous political basis for resistance to communism in Germany requires, as in France and Italy, two major types of action. First, much improved economic performance in the bizonal area is necessary. Second, some coherence of German moderate non-communist leadership in the western zones must be developed. Even more obviously, perhaps, than in Western Europe, these two requirements are organically related in the same fashion as the chicken and the egg; it is impossible to tell which must be done first.

Economic recovery in Germany, which is discussed more fully in subsection C (2) below, is both a necessity for the development of political leadership and a prerequisite to it. As in Italy, adequate administrative machinery needed to achieve effective distribution of coal and food, which is in turn needed to stimulate production, cannot be established without a broad basis of political support from among the moderate parties. Effective cooperation of responsible German leaders cannot be obtained unless the latter see hope ahead for a continued improvement in the economic situation which warrants them in cooperating with the occupying forces for the benefit of the electorate to which they must appeal.

At the political level, the core of the present difficulty in developing effective non-communist leadership in the bizonal area lies in the fact that the British and American military governments appear to be more concerned with maneuvering for position between left of center (the British socialists) and right of center (the American Christians) than they are with developing a common ground from which all moderate parties can take a firm stand against the extremes of Nazi and Communist thought. Internecine warfare among the middle groups tends to polarize political thought in Germany rather than to develop cohesive central leadership which will draw support away from the extremes.

In the political sphere, the solution to the twin problems of economic recovery and the provision of German leadership lies in a compromise between British support for the SPD and American support for the CDU separatists. Excessive concern by the US for decentralization in economic matters, for free enterprise, abolition of controls, etc. must give way to a real attempt to find a genuine middle ground. The present attempt to build a top-heavy structure providing checks and balance as between the Socialists and Christian Separatists will, if carried to completion, defeat the entire program. The development of centripetal political forces in Germany to replace the present centrifugal forces is the primary task of British-American policy in Germany and one which is not now being met.

It is not clear that Germany is ready to respond to an appeal which goes beyond this level and asks her to take a role in the reconstruction and economic recovery of Europe as a whole. The depths of self-pity in Germany are still being plumbed. The Germans are still too intimately concerned with their own sufferings and are unaware of the existence of comparable economic problems elsewhere. Moreover, such slogans as the “integration of Western Germany into Western Europe” are interpreted by the Germans in their current mood as the granting of license to France, Belgium and Switzerland to use German resources for their own benefit without corresponding benefits to Germany.

The temptation lies in the other direction to appeal to German nationalism. The Soviet Union has already embarked on this course of propaganda by supporting at Moscow strong central government and opposing dismemberment of Germany in the West. The United States has attempted to compete as a champion of German nationalistic sentiment in calling for the revision of the German boundary with Poland.
If our European program is to take a Europe-wide approach to European economic and political recovery and to fit Germany into the European pattern, German nationalism cannot be emphasized except at the cost of awakened fears in the other European countries. While for the moment it is impossible to stimulate any interest in Germany in the community of European nations, it may ultimately be possible to do so when more effective and responsible leadership in Germany has been developed on the basis of a progressive amelioration of economic conditions. During this period, the gains to be derived from competing with the Communist Party for the role of champion of pan-Germanism are probably outweighed by the damage which will be done to the prospect of a European-wide community of interest.

There is then little that can be done for the moment to stimulate the Germans to take an active role in the development of a European political and economic recovery. Germany should be brought along with this development rather than pushed into the vanguard. The task of preparing a basis for responsible political leadership in Germany, however, is sufficiently challenging in its own right and is in any case a prerequisite to tying that leadership into a broader European economic and political framework.

C Raising the Mass Living Standard of Europe

To raise the mass living standard of Europe (which, as we have seen, is a prerequisite to obtaining a favorable European settlement with the USSR) requires a European Recovery Plan buttressed by United States financial and commodity assistance and by United States economic policy in Germany. Drastic improvement of internal economic policy and administration in France and especially in Italy will also be essential.

(1) The European Recovery Plan

The political role of a continent-wide European Recovery Plan, as a symbolic goal to strengthen left-center leadership in non-communist Europe and to recreate hope for the future, has been discussed above. It is the purpose of the following paragraphs to explain the economic necessity for such a plan and to describe in summary fashion its nature.

(a) THE ECONOMIC CASE FOR A COORDINATED EUROPEAN RECOVERY PLAN

In economic terms, the heart of the European problem is inadequate production, and resulting shortages, caused primarily by the war and its aftermath. These shortages of almost every conceivable type—food, fuel, raw materials, transportation, industrial equipment and of foreign exchange, especially dollars—constantly harry the economic officials of all major European countries. Some of these shortages are due to over-all supply limitations in a specific commodity (e.g., cereals, coal) perhaps aggravated by an unprecedented demand (e.g., lumber). Others even more difficult of solution are due to the generally depressed levels of all production and to disruption of the normal production and trade patterns of the European economy (e.g., foreign exchange).

In response to the pressures of these shortages, decisions are being made and conditions are being allowed to develop within the too limited framework and outlook of national economies which are distorting the pattern of European production and trade and in general are preventing a maximum effort to achieve recovery of Europe as a whole.
To give only a few of the most striking examples:

(1) The US and UK occupation authorities in Germany have funneled most of the foreign trade of the bizonal area through the German ports of Hamburg and Bremen in order to save foreign exchange. This step was taken even though Dutch and Belgian ports had handled a large share of German trade for hundreds of years and are admittedly the lower cost route and the natural entrepôt for the Ruhr and Rhine industrial areas.

(2) The Czechs are threatening to divert their overland carrying trade from its normal routes via the North German ports to some less efficient outlet such as the Polish ports because they cannot afford to pay rail freights in dollars at the rates requested by the United States occupation authorities in Germany.

(3) Exports of forest products from the Scandinavian countries are below prewar, in spite of a desperate European housing shortage, because the coal shortage forces an uneconomical use of timber as fuel.

(4) The coal mines of Britain and France are short of labor although there are 2,500,000 unemployed in Italy and unknown numbers of Germans are hindering recovery in the bizonal area by supporting themselves in the black market and in other non-productive activities.

(5) An already over-burdened railroad system is forced to carry Polish coal across the continent from the Silesian mines to France and to haul Ruhr coal in the opposite direction to Berlin.

(6) Italian, Dutch and Greek vegetables and fruits cannot be marketed and are left to rot in a continent where almost everyone has a vitamin deficiency.

(7) The conduct of most intra-European trade through bilateral clearing accounts narrows the marketability of all but the most highly essential materials and products. Exporters of less essential goods are forced to accept very disadvantageous trade terms in order to obtain needed imports, although much better terms could be obtained from third countries. Conversely, an importing country is forced to accept in payment goods of limited usefulness to its economy but badly needed in third countries.

(8) Limited supplies of German steel are used to manufacture cameras and toy trains for export to the United States rather than milking machines to increase Danish and Dutch dairy production or desperately needed spare parts to increase the productivity of undermaintained European machines.

(9) Almost every country in Europe has or is developing a two, three, four or five year recovery plan, but there has been almost no coordination of these national plans to determine whether they make sense in relation to each other. For example, France, Luxembourg, Czechoslovakia and Poland are all asking for credits to develop steel production. The bizonal authorities in Germany are planning a large revival of Ruhr steel output. There may well be waste which Europe cannot afford unless there is a coordinated continental steel program, geared to total European coal availabilities, which is designed and administered to meet the end uses most essential from a general European viewpoint.

(10) Perhaps the most striking single example of national economic policy pursued without regard for the interests of European recovery as a whole is the failure of the United States and British occupation authorities to raise production in Germany and to orient
that production (and the German market) in part toward the needs of Europe. Some of
the complex ramifications of this issue are discussed in subsection C(2) below.

After a fast start during 1946, European recovery has slowed down, with over-all pro-
duction, both agricultural and industrial, and exports still well short of prewar levels. The
two most important limitations are still food and coal supply; but, as had for some time
been foreseen,\(^1\) the almost totally uncoordinated nature of national economic policies, of
which the above instances are illustrative, is now becoming an increasingly important brake
on recovery. As long as production and trade were at very low levels, national (and even
local) efforts to break immediate and clearly defined bottlenecks were adequate and effec-
tive. As production approaches the general limitations set by present plant capacity and/
or manpower, however, the highly specific type of bottleneck tends to disappear, and a
continuation of rapid recovery becomes dependent on a conscious attempt to rebuild the
complex and delicate pattern of intra-European production and market relationships which
were disrupted by the war.

Dollar resources in Europe are now running very low. But the American people and the
Congress are understandably reluctant to commit themselves to further financial credits
which simply keep individual countries afloat without any assurance of putting an end to
the strain on the taxpayers’ pocketbook. To give them such assurance, what is needed is a
European Recovery Plan which will:

1. provide a renewed impetus to production and recovery;
2. maximize the intra-European trade and production potential;
3. cover all countries requiring aid;
4. provide satisfactory assurances of enabling Europe to stand on its own feet in a reason-
able period of time;
5. provide a definite limit, both in time and amount, to the expenditure of United States
   funds;
6. achieve recovery in the shortest possible time and at the lowest possible cost to the
   United States.

(2) Economic Recovery in Germany [pp. 58 ff. of original memorandum]
As the most important industrial power in Europe and the area where US and Soviet politi-
cal aims and substantive actions are most closely joined, Germany is of crucial importance
for the attainment of our two long-run objectives in Europe. It is in Germany that the
feasibility of practical cooperation with the Russians will be finally determined. As we
saw above, it is Germany which must be the principal subject of the European settlement
which is the short-run objective of our European policy. And it is on Germany that the suc-
cess of the European Recovery Plan recommended in this memorandum in large measure
depends.

(a) ORIGINAL PREMISES OF UNITED STATES POLICY IN GERMANY
The German policy of the United States immediately after unconditional surrender was in
large measure based on the first of the long-run objectives of our foreign policy: the attempt
to find a basis of accommodation with the Soviet Union. Since the substance of contem-
porary Soviet policy toward Germany was in harmony with large segments of American
opinion as to the proper treatment of that country, such a basis of accommodation at the
time appeared to be readily attainable.

There were, to be sure, major elements of purely German policy involved: the drive to
punish the Germans for the evil they had done; the desire to restrain them economically,
partly for fear that their powers of recuperation would prove stronger than those of the rest
of Europe, and partly for fear of future aggression: the purely negative determination to
avoid the mistakes of the German policy of the First World War. Underlying all this policy,
however, was the view that Germany’s most appropriate penance for her sins of aggression
would be to serve as neutral ground between East and West where negotiation and compro-
mise would provide a basis for adjustment. Thus American support for reparation removals
of industrial equipment sprang partly from the objective of disarmament, and partly from
the search for a formula which would avoid the necessity for American financing of repara-
tion payments. The final impetus to acceptance of the removals plan was given, however,
when it was found that it had already been put into effective, if unplanned, operation under
the aegis of the Soviet Army; and that, as a result, no other basis existed for a reparation
agreement acceptable to the Soviets.

In this concentration on German policy primarily as an instrument of accommodation
with the Russians, and secondarily as an instrument of punishment and restraint, such
attention as was devoted to general European problems was largely negative. The liberated
countries were to be protected against a surge of German economic recovery which might
impede their own reconstruction, and against the possibility of future German aggression;
and they were to receive such items of capital equipment the removal of which from Ger-
many was deemed necessary for disarmament. Small heed was given, however, to the pos-
sibility that Germany might make a major contribution to European recovery.

(b) THE SHIFT IN PREMISES
Two years of frustration in attempting negotiation with the Soviet Union have produced in
many quarters an attitude of mind based almost solely on the second of our long-run objec-
tives: the attempt to secure strategic advantages to improve our chances of winning a pos-
sible war with the USSR. Thus Mr Hoover, for example, pays lip service to certain aspects
of present German policy—to denazification, democratization, demilitarization, etc.—but
hits hard at all restrictions of an economic character, including particularly the notions that
the recovery of Germany should be slower than that of liberated countries, that Germany
should pay reparation, and that German cartels should be eliminated.

Two years of continuing and heavy American financial contributions to the support of
Germany have produced an almost equally widespread attitude of mind which concentrates
on the necessity for making Germany a paying proposition. In certain quarters this urgent
desire to get the Germans off relief virtually obscures the fact that nearly every other coun-
try in Europe is also living on credit, and obscures also the possibility of the resurrection of
a powerful Germany, waxing strong on the competitive favors of East and West.

The quadripartite frustration and continuing financial deficits described above have, in
combination, proved a powerful stimulus to re-examination of the original premises of
United States policy toward Germany. The original aim of finding a basis for accommoda-
tion with the Soviet Union has been retained, however dimmed the original hopes, but to it
has been added the second aim of securing strategic advantages for possible eventual war
with the Soviet Union. With the diminished emphasis on placating Soviet suspicions and fears to the utmost, it has become possible to devote increased attention to the implications which German policy holds for general European policy, and, conversely, to the bearing of certain European policies on German policy.

It has been found, for example, that measures aimed at the full or partial reconstruction of the German economy, which might in some quarters be advocated as a means of securing strategic advantages against Russia, or as a means of reducing the United States contribution to the support of Germany, might also serve the reconstruction of Europe. Thus it has become apparent that large-scale dismantling of the German machinery industry would leave Europe poorer in machinery production—at least for the extensive period of time necessary to transfer plants as reparation and to restore them to operation. It has also become clear that the drive to secure coal for Europe from German mines cannot be pursued to the point where no coal remains for German consumption. The German problem has increasingly come to be seen not merely as a Russian problem, but as a European problem.

Present United States policy toward Germany, therefore, is a curious amalgam. It retains strong elements of uniquely German policy: demilitarization, disarmament, democratization, decartelization, etc. In addition, however, it now regards Germany as an important part of Europe, with repercussions of United States policy in Germany flowing from that country into all parts of Europe. Like all United States foreign policy, policy in Germany is of necessity afflicted with the schizoid attitude toward the Soviet Union: solidarity forever if at all possible, but a well-protected flank if not. Finally, like all United States policy in all fields, German policy aims at achieving its objectives with the least possible expenditure of United States funds. No one of these four strands of policy, however, predominates over the others.

(c) AGREEMENTS EMBODYING POLICY
The Potsdam Agreement embodied fully the original premises of United States policy toward Germany. Its basic economic provisions for Germany were: (a) the restriction of the level of industry to 50 to 55 percent of that existing in 1938; (b) the removal as reparation of all industrial equipment in excess of this permitted level; and (c) the agreement that Germany should be operated as an economic unit, with pooling of economic resources and expenses without regard to zonal boundaries. The Level of Industry Agreement of March 1946 represented the closest approach to quadripartite fulfillment of these economic provisions. General Clay’s stop-order, in May 1946, on further dismantling of plants for reparation purposes, pending the achievement of economic unity, represented the first overt recognition of the failure of Potsdam. The US-UK Agreement of December 1946, for the economic fusion of their two zones in Germany, with the aim of achieving economic self-support for the area within three years, marked the final recognition that the likelihood of the Soviet Union’s carrying out the Potsdam contract for economic unity was remote.

Insofar as it was related at all to United States policy, the reparation stop-order represented in large part purely German policy, a desire to retain in the United States Zone sufficient resources to compensate for possible failure to achieve economic unity, and thus to avert a possible increase in the American taxpayer’s contribution to German support. The agreement for the fusion of the US and UK Zones likewise represented in large measure the
desire to make Germany self-supporting, although there was additional rationale concerning the attractive effects the fusion would exert over the other zones. Except for the special case of coal, it was not until the Moscow meeting of the Council of Foreign Ministers that the policy of regarding Germany as a part of Europe was embodied in international agreements concerning Germany.

At the Moscow session a number of decisions were taken, for the most part outside the normal quadripartite business of the Council, which have affected US-UK economic policy in Germany. The four powers agreed in principle to increase the level of industry to be left in Germany after reparation removals; and the Secretary of State and the British Secretary of State for Foreign Affairs agreed to go forward with the calculation of a revised level of industry for application to the combined US-UK Zones. In the statements on the subject by the United States Delegation, the major basis for revision was given as the necessity to retain in Germany sufficient industrial capacity to produce goods required, not only by the minimum peacetime German economy, but also by European countries which could purchase them from Germany on commercial terms. British acceptance of this basis of revision has been tacit rather than explicit. The thought, however, that the peacetime commercial requirements of Europe for German goods should be taken into consideration in the determination of the level of industry to be left in Germany, represents a sharp departure from the criteria of the Potsdam Agreement, and a step toward treating the German economic problem as a part of a wider European problem.

The United States, Britain and France, moreover, reached at Moscow a new agreement on coal exports from Western Germany, superseding the tripartite coal directive of July 1945. The early directive called for the export of 25 million tons of coal from Germany during the last five months of 1945 and the first four months of 1946, without requiring the retention in Germany either of an absolute amount or a particular percentage of German coal production. German coal production never reached a sufficiently high level to permit the directive to be carried out. The Moscow Agreement, which governs the last six months of 1947, provides for a sliding scale under which gradually rising proportions of net merchantable coal production are to be exported as total coal production in the Ruhr and Saar increases. Germany is therefore permitted to retain an increasing absolute amount of coal for her own use.

Thus, in conjunction, the agreements reached at Moscow mark the consummation of the shift in premises from the days immediately after the war when Germany and liberated Europe were regarded as separate problems. Both the new coal agreement and the new level of industry agreement recognize that conflicting German and other European needs must be resolved on a mutual basis.

(d) CURRENT ECONOMIC CONDITIONS IN GERMANY AND EUROPE
The changes in policy, and the corresponding changes in international agreements described above, have taken place against and been conditioned by a background of economic conditions in Germany and the rest of Europe which have fallen progressively below the sharp upward trend which was anticipated two years ago. Industrial production in Germany is only 45 percent of the 1936 level, although total industrial capacity is undoubtedly much higher than in 1936. Coal production in the Ruhr is only slightly more than 50 percent of prewar. Food consumption in urban areas still hovers around and below the disease and
unrest level. Distribution of all products is chaotic, and economic remedies are in large measure impossible to enforce.

Yet the state of Germany, commonly referred to as economic prostration, represents only a more acute version of that of the rest of Europe. All industrial areas of Europe are gravely short of food and coal, and of raw materials, and these shortages impose a tight brake on general industrial production. Not only Germany, but all European countries are dependent on United States dollar credits for a critical proportion of the food, materials and equipment needed to keep their economies running on a mere maintenance basis. Nor is the prospect in sight that this dependence will cease within the near future.

The basic causes of Germany’s state of chronic collapse, reflected in varying degrees in other European countries, are partly political and partly economic. Most fundamental and general, overshadowing the more specific causes, is a failure of organization and will, a failure which is so acute that even the most elementary economic remedies cannot be made effective. Despite the lack of coal for the most urgent use, it is known that a substantial fraction of the coal retained in Germany disappears into the black market. The population of Bavaria puts on weight while the search of Ruhr miners for black market food sends the absenteeism rate up to 33 percent. There exists in Germany neither an effective administrative apparatus for enforcing unpopular decisions, nor a political structure for enlisting the support of the bulk of the population behind the economic goals which are essential for the good of the community.

Under the conditions of low-level production and consumption which dominate Germany today, the apparent immediate good of the individual is sharply and continuously in conflict with the general good of the community, and no effective means for harmonizing or suppressing this conflict are at hand. Under these conditions, the entrepreneur is interested in production primarily for the repair and maintenance of his plant, but not for the community interest. The worker concentrates attention on the maintenance of himself and his family, as against output which would benefit the community as a whole.

In the face of this basic and uncontrolled conflict of motives, the other causes of Germany’s economic stagnation seem secondary. The retention of a greater amount of the Ruhr’s coal production for use in Germany would undoubtedly improve industrial output; but the first step must be to ensure that the coal already being retained is put to effective use. A large increase in rations for the Ruhr miners would undoubtedly increase coal output; but, unless effective steps can be taken to ensure the equitable distribution of the food produced by German farmers, such an increase could be made only at the cost of the American and British taxpayers. Lack of economic unity, the necessity for financial reform, lack of funds for the importation of raw materials, uncertainties created by the prospect of reparation and restitution, disturbances due to denazification, etc.: all these are contributory obstacles to German production. Unless accompanied by fundamental administrative and political reform, however, the overcoming of any or all of the obstacles could provide only a temporary and limited stimulus to German recovery.

(e) BASIC UNITED STATES POLICY TOWARDS ECONOMIC RECOVERY IN GERMANY

The United States desire to promote economic recovery in Germany rests on four strands of influence noted in the discussion of the basic premises of United States policy: the aim
that Germany should become a democratic, peaceful state; the aim of securing in Germany both the possibility of cooperation with, and strategic insurance against, the Soviet Union; the aim that Germany should contribute to general European recovery; and the aim of minimizing American expenditures. It is, for example, agreed that democracy cannot take root in Germany if the Germans are unable to fill their bellies. It is considered that the most effective means of achieving economic unification of the four occupation zones of Germany is to make the bizonal merger of the British and American Zones an economic success, since the Russians cannot afford to keep the Germans in the Eastern Zone out of a success. The restoration of German trade is important to Europe as a source of goods and an outlet for surpluses. And finally, economic recovery would make possible the stoppage of United States appropriations for feeding the Germans.

Economic recovery is easily chosen as an end of policy; its attainment, however, or even agreement on the means for attaining it, is less easy. Prescriptions are practically as numerous as doctors. It has been suggested that to restore industrial activity in Germany we need: (a) more centralization; (b) abandonment of the policies of denazification and decartelization; (c) abandonment of the level of industry plan and reparation out of capital equipment (the Hoover nostrum); (d) large-scale imports of capital into Germany; (e) retention of scarce commodities by Germany, such as coal, lumber, potash, etc.; (f) increasing German consumption in all lines; (g) over-riding priorities for production of critical items, such as food, coal and exports, etc., etc. These conflicting views reflect the conflicts inherent in the four basic premises of United States policies; the reconciliation of such of them as merit serious attention must be a question of emphasis and timing.

These conflicts may be illuminated by the sharp contrasts between British and American policy toward German recovery which existed prior to the fusion of the two zones, and which still vex bizonal negotiations. Most basic is the question of the proper political and administrative organizations of Germany—centralization vs. decentralization. The British have wanted strong central economic agencies, heavily staffed with both German and Allied administrators—the Germans to bear the full responsibility, and the Allies to exercise final authority. The Americans have stood for decentralized agencies, operating through the eight Laender governments and with checks and balances of the American variety for the reconciliation of differing German interests. Neither system has proved capable of dealing with the problems of modern government in a prostrate economy such as Germany’s today.

Government in the British Zone is weak because administrative agencies are top-heavy and muscle-bound, teeming with bureaucrats and face to face with a long line of British administrators who must approve each action at each step in its development. Capable and honest Germans refuse to work in such a set-up. In the American Zone, government is weak by design. The Laender meet as equals: action can be taken only by unanimous consent, plus the endorsement of military government.

The result of weak government in both zones has been economic chaos, with the black and gray markets absorbing large fractions of the scarce commodities on which recovery depends. The wartime experiences of all belligerent countries, including the United States, demonstrated conclusively that the price system cannot be relied on for equitable and economically effective allocation of critical goods in short supply; yet the black market price system now governs by default large segments of the German economy. There can be no
doubt but that strong, central control is an essential prerequisite to the economic recovery of Germany.

A second important conflict between American and British recovery policy has been over the question of economic priorities. In the American Zone, overriding priorities have been given to coal, transport and food, in the conviction that recovery in these fields would automatically bring with it more general recovery; and that concentration of effort is essential to success. In the British Zone, however, an attempt was made to re-activate the entire economy at once. The Ruhr economy collapsed in the spring of 1946 and again in the winter and spring of 1947. Scarce building materials were shared so widely that progress was equally slow in all areas, and only 2 percent of the available supply went to miners’ housing. It seems clear that this diffusion of effort in the British Zone has defeated its own ends. It is believed that it is impossible to achieve economic recovery in Germany except by strict and overriding priorities for the key sectors of the economy, and allocations of all needed goods to their most critical uses, at whatever cost (within practical limits) to the rest of the economy.

A third difference of principle, related to the foregoing, is found in contrasting British and American attitudes toward exports and imports. In the British view the critical problem of the German economy is not effective administration, but general shortages of all types of goods. The British therefore tend to suggest that the German need for German production of coal, steel, machinery, etc. is more acute than that of other countries; and that, indeed, there should be a substantial expansion of imports into Germany. Exports are crucial to Germany; imports are both warranted and essential. To the American group, exports are a necessity (to reduce the cost of feeding the Germans at a pace at least as fast as Congressional appropriations are likely to be cut); and imports, unless needed to produce exports, are anathema. The practical reasoning of the American representatives is compelling of itself. As a matter of principle, however, it may be added that American aid to any country will be wasted if it is received without concurrent attempts by that country to use its own resources and outside aid to make itself self-supporting.

Finally, some attention should be paid to the suggestion that reparation removals of capital equipment from Germany are impeding recovery. This suggestion is regarded by most experts as nonsense. The Level of Industry Agreement of March 1946 was subject to criticism, since it fixed a level which was too low in relation either to Germany by itself or to a Germany bound in intimate trade ties with Europe. But the suggestions that the German war economy is an appropriate economy for a peacetime Germany (aside from factories producing final armament products), and that a reduction of German steel capacity from 21 million tons per year to 12, 19, or \(7\frac{1}{2}\) million prevents current output from surpassing 3 million tons a year, cannot be accepted. Some reparation must in justice be paid by Germany to the countries it warred against. To deliver to these countries capital equipment which the Germans used only for war-making is both good German policy and good European policy.

In conclusion, it should be stated that appropriate United States policy for economic recovery in Germany must suffer the handicaps of other strains of United States policy—democratization, decartelization, reparation, and restitution, general European recovery, keeping US expenditures to a minimum, etc. For the immediate future, it should concentrate on:
(1) The development of adequate administrative machinery in Germany capable of carrying out a program of overriding priorities for production of food, coal and exports, and of preventing the diversion of these goods into wasteful German consumption.

(2) The maximization of productive effort on a few key items of the German economy—food, coal and exports—by giving them the highest priority in claims on managerial ability, on labor and on goods.

(3) Channeling the maximum proportion of German production into the export markets, and keeping imports to the minimum. (In view of the increasing reluctance of British and American taxpayers to contribute to German support, this development is essential to German recovery.)

It is possible that, when in the more distant future general European production and consumption have reached adequate levels, a more general program for German economic recovery will need to be developed, a program calling for heavily increased German production and consumption in all fields. To initiate such a program now, however, at a time when European recovery is critically dependent on German production of coal and other goods, and when the American contribution to German relief is faced with reduction rather than expansion, would be self-defeating. There is no likelihood that the American funds necessary to support such a program would be forthcoming. Without such support, the program would fail in Germany through diffusion of inadequate effort; and would seriously retard the recovery of other European countries.

(f) GERMAN RECOVERY IN RELATION TO EUROPEAN RECOVERY

It is evident that United States policy toward Germany’s economic relation with other European and foreign countries will differ according to the extent to which German recovery is sought by itself, or as part of a general program of economic recovery for Europe. In neither case can the United States allow other European countries to be subsidized by Germany, or, more accurately, by the United States through Germany. At the same time, choices must be made concerning the pattern of production and consumption in Germany, the proportions and types of goods to be exported, the countries to which German exports should be sold and from which imports should be purchased, and the currency in which payment for exports should be made.

One of the most important examples of the choices which must be made is found in the urge of American officials in Germany to expand exports and restrict imports, a policy which tends to take a form peculiarly German—and anti-European—in orientation. The utmost in value should be exported. Coal should be retained in Germany in order to produce exports worth three to four times as much, since they embody German labor. (European countries, however, need coal from Germany in order to employ their own idle labor in plants which cannot get coal from other sources.) For the same reason, lumber should be manufactured into radio cabinets for sale in the United States, rather than into floor sections for housing reconstruction in France. Conversely, the most extreme lengths should be gone into to avoid imports. Thus Bremen and Hamburg should serve as ports for the Ruhr and Southern Germany, even though Antwerp and Rotterdam lie on the direct routes from overseas, since the use of Rotterdam and Antwerp costs foreign exchange.
Another aspect of the same problem is presented by the shortage of dollars in Germany and throughout Europe. The bulk of the expenditure for aid to Germany is made in the dollar area, partly as a matter of necessity and partly because of administrative convenience and inertia. This suggests to officials in Germany the desirability of attempting to collect for the proceeds of exports in dollars, and of manufacturing goods for the dollar market regardless of the needs of neighboring European countries. Hence an attempt is made to collect dollars for transit traffic across Germany to and from Czechoslovakia, despite the fact that Czechoslovakia claims that she has no dollars to pay with; and to sell soda ash to Libbey-Owens-Ford in Illinois for the manufacture of plate glass, rather than to Belgium, which needs soda ash to make milk bottles.

The requirement that dollars be paid for German exports has been watered down in practice from its original bare character. Clearing agreements were established with European customers of Germany, with purchases and sales offset currently and only unpaid balances settled in dollars every six months. Moreover, under the bizonal fusion, settlements could be made in dollars or sterling, with the UK undertaking to convert sufficient sterling into dollars to maintain the bizonal agency’s buying power for essential raw materials in dollars. Despite these economic concessions, however, the fact remains that German sales to Europe are handicapped by the dollar requirement lurking below the present payments arrangement; and that strong pressures continue to exist in Germany both to manufacture goods suitable for dollar sales rather than goods required in Europe, and to prefer American to European sales of identical products.

If it be agreed that Germany should export to the limit, the question remains what she should export, to whom, and in what currency. And if it be agreed that Germany must be economical in importing, the question still requires answer whether normal and constructive trade relationships in Europe should be altered to save foreign exchange. The possibility exists that German policy could be modified from its present rigid cast if US policy in Germany were to be merged into US policy in Europe.

It is evident that the answers to these questions depend partly on the policy pursued regarding relative rates of economic activity. The United States has in general adhered to the policy that economic recovery in liberated areas should take precedence over that of Germany, although a number of the detailed United States policies in Germany, noted above, are in fact in conflict with this policy. The time has perhaps come when, without halting the recovery of the liberated areas, it is appropriate to allow German industrial activity to begin to catch up more rapidly; and it is possible that such a policy, if pursued within the framework of a European program, would make a more substantial contribution to general European recovery than does the present restrictive and confused one.

These manifold relationships of German to European economic recovery have been explored as far as possible in a general paper of this character. The conclusions that can be drawn must be equally general. The major conclusion must be that all United States policies for German recovery should be tested not only according to their contribution to recovery in Germany and to the reduction of the United States financial burden in Germany, but also according to their contribution to European recovery and to the reduction of the United States financial burden in Europe generally. So long as no general European recovery program exists, this is a difficult test to apply. As a prima facie test, however, it may be taken that any German policy which tends seriously to distort constructive prewar
trade relationships, or to restrict general European trade opportunities, is a bad policy. There may be compelling reasons of finance or politics which make the adoption of such a policy unavoidable, but they should be subject to the sharpest scrutiny.

Perhaps an effective way to reduce the dollar barrier to German trade in Europe would be to incorporate in any program of American aid to Europe a credit which would be available only for imports from Germany. The sum of, say, 2 billion dollars might, for example, be allocated to the European aid program but assigned not to one country, but in small amounts to such countries among a stated list as wanted to buy goods from Germany on credit. The debts would be owed to the US by the importing country. Germany would receive the funds only as goods were produced and sold by her to Europe. German trade in Europe would be stimulated, however, and the dollar barrier to purchases from Germany would be substantially lowered. An arrangement of this sort would be administered through the European clearing agency suggested in subsection C (1) above [not included in present volume]. It could be combined with an adjustment in the export price of German coal, now too low. It would also have the advantage of suggesting the European-wide character of the recovery which the United States seeks.

From the side of Germany, it might well prove that a bizonal recovery plan which explicitly recognized the needs of Europe, and which related the planned pattern of German production, exports and imports to those needs, would act as the effective catalyst to the formation of a European recovery plan. Such a bizonal recovery plan should be limited in scope, concentrating on key sectors of the German and European economies. It is believed, however, that sufficient information is now at hand to permit the formulation of such a plan. Neither the dollar problem nor the production problem can be solved without the economic unification of Germany and of Europe.

Note

1 See, for example, UN Subcommission on Economic Reconstruction of Devastated Areas, Report, pt. 3, ch. 3, July 1946.
References

1 1947 Excerpts from the Cleveland-Moore-Kindleberger Memorandum of 12 June 1947, on a European Recovery Program

Beloff, Max (1963), The United States and the Unity of Europe (Washington, DC: The Brookings Institution).


I Introduction 1

II Summary 2

(part)†

III Objectives and Premises of a United States Program for Europe 20

A Premises and Long-Run Objectives 20 B Short-run Objectives 22

IV The Program 26

A Introduction 26 B Political Goals and Leadership 28 (1) France and Italy 28 (2) Germany 35† C Raising the Mass Living Standard of Europe 41† (1) The European Recovery Plan 41† (a) The Economic Case for a European Recovery Plan 41† (b) Outline of the European Recovery Program 45 (i) Production and consumption goals 47 (ii) Measures to achieve the production objectives 48 (c) Eastern Europe and the Recovery Plan 51 (2) Economic Recovery in Germany 58† (a) Original Premises of United States Policy in Germany 58† (b) The Shift in Premises 59† (c) Agreements Embodying Policy 61† (d) Current Economic Conditions in Germany and Europe 64†
United States economic policy in Western Germany will be of critical importance to the success or failure of the European Recovery Plan. Unfortunately our economic policy in Germany to date has neither been consistent nor has it taken adequately into account the functional relationship of Western Germany to the European economy. As regards its consistency, United States German policy originally was based upon a severely restricted premise under which the Germans were to be economically disarmed and left to their own devices for recovery. The economic disarmament aspect of this policy fitted into the broader objective of reaching agreement with the USSR in Germany where Soviet policy was harshly restrictive. Following failure to achieve agreement with the USSR on the basis of a restricted Germany, an attempt has been made to coax the Soviet Union into economic collaboration through the promotion of economic recovery. With respect to the relationship of Germany to Europe, there has been a shift from the original aim of
restricting German economic activities

whatever the cost to the rest of Europe toward that of creating a self-supporting bizonal area

in three years (to relieve the United States taxpayer), again, whatever the cost to Europe. At the moment United States economic policy in Germany is in a state of flux. As interpreted by the American authorities in charge of the occupation, the primary tasks are

- to create a self-supporting economy, achieve agreement with the USSR, and to promote free enterprise at the expense of socialism. In Washington, on the other hand, importance is attached to creating a self-supporting economy and to reaching agreement with the Soviet Union, but emphasis is additionally placed upon promoting German recovery in the context of a European-wide recovery. The attempt to impose American economic institutions on Germany is not regarded as fruitful. The task of obtaining agreement between United States government policy as laid down in Washington and as practised in Germany is a major precondition for success in producing recovery in Germany. The current economic situation in Germany is characterized by low levels of production, almost complete lack of control of distribution, and administrative machinery inadequate to the accomplishment of United States aims in the planning of production and foreign trade. Production of coal in the Ruhr, which had recovered from 185,000 tons a day to 238,000 tons a day in March 1947, has again been set back by a crisis in food. This food crisis took effect first in the Ruhr despite agreement in
principle that the miners’ rations
should be isolated from the effects of food shortage.
Production of food was held back by
low production of fertilizer which can be increased only
with increased amounts of coal.

Programming of exports, except of a few commodities such as
coal, lumber, hops, etc., has
been put on a private enterprise basis with the result that
resources cannot be directed into

productive channels necessary for Europe. Primary
requirements of the present situation in Germany are
programs (1) to increase

the production of coal and food; (2) to allocate coal and
food internally in Germany in

the most effective fashion; and (3) for production of
exports which will take into account

to the maximum extent possible the recovery needs of the
European economy within the

framework of the European Recovery Plan. In the pursuit of
all these objectives, adequate

administrative machinery, whether German or Allied, is
needed to prevent individual

businessmen, workers and farmers from refusing to produce
or from diverting production

into wasteful channels. Sufficient financing must be
available to provide Germany with the maximum amount

of food which can be obtained in world markets up to the
2,600 calories provided for in

Allied planning. The present normal consumer’s ration of
1,550 calories per day, which

has not been met, is inadequate. The short-run ration goal
of 1,800 calories for the normal

consumer, which cannot be met during the present crop year,
is the immediate aim. Other
financing of German imports should be restricted to the necessary raw materials to produce exports and the minimum consumers incentive goods necessary particularly for miners and farmers. It is not considered desirable to import goods for general consumers in Germany or for capital investment until clear needs which cannot be met from German resources have been revealed. Finally, adequate financing via the ECE clearing agency mentioned above of European purchases of German goods should be made available to remove the present obstacle of the dollar requirement in the way of German exports to Europe. IV The Program B Political Goals and Leadership

(2) Germany [pp. 35 ff. of original memorandum]

The problem of setting political goals and stimulating effective non-communist leadership in Germany is broadly analogous to that in France and Italy. It is, however, complicated by two major factors: first, that there is no German government; and second, that there have already developed certain mutually contradictory patterns of American and British behavior in Western Germany in relation to local political developments. A third factor which in some respects complicates the problem but in others makes it easier of solution is the fact that Eastern Germany is occupied by Soviet forces which furnish both competition and contrast to Anglo-American performance in Western Germany. The necessity of creating German administrative organs in the bizonal area without a
German government increases the difficulty of developing political effective leadership in Germany in two respects. On the one hand, the occupying forces encounter difficulty in securing the cooperation of German leadership because of the reluctance of local leaders to serve foreign powers. On the other, the responsibility for creating adequate administrative machinery is laid squarely at the door of military government and cannot be shifted to the German people. Disparate development in political structures in the British and American zones is an equally important obstacle to development of effective non-communist leadership. In the American zone, military government has, partly through ineptness, directed its appeal to the conservative and separatist sentiments in Southern Germany. It has offered Germany the typically American slogans of free enterprise, small-scale business, frequent elections, etc. which are to a considerable extent irrelevant to the immediate needs of the population, and has exhibited hesitancy and fear if not outright opposition to trade unions, public ownership, anti-fascist popular fronts, and similar socialist-type symbols and policies. It has transferred responsibility for government to Germans in large doses—perhaps at a faster rate than the Germans have been able to take it on. And it has not always accompanied this responsibility with the grant of commensurate executive powers. Despite directives from Washington instructing the Office of Military Government to refrain from interfering in
German political matters, the background of personnel at all levels of the occupation in Germany has been such that interference has taken place after the transfer of responsibility and has supported the more conservative elements in the community. In the British Zone, on the other hand, military government has openly interfered in German politics. This interference has, however, been contradictory in character. British policy statements have supported socialism in Germany with Germans in control; at the same time the zone of occupation has been unofficially used to protect British investments and to find an inordinate number of jobs for British civil servants, thus withholding responsibility from the Germans. The differences in British and American policy in the separate zones have recently been strikingly revealed in negotiations required to constitute the bizonal administration. The fact of Soviet occupation of Eastern Germany has made competition among the occupying powers for the favor of the German population more acute in economic matters such as employment, standard of living and food rations. Other competition is revealed in intellectual and cultural fields where Soviet policies in Germany are even more striking than those of the American and British. The Soviet Union has sought a “friendly” govern ment in Eastern Germany (i.e., a government subject to control). At the same time it has been anxious to obtain maximum reparations from Germany, in capital equipment and in
current production. Had it not been for Soviet unlimited demands for reparation, our com
parative success in keeping German thought in Germany oriented toward Western Europe
would have been far less. The development of an adequate indigenous political basis for resistance to commu
nism in Germany requires, as in France and Italy, two major types of action. First, much
improved economic performance in the bizonal area is necessary. Second, some coherence
of German moderate non-communist leadership in the western zones must be developed.
Even more obviously, perhaps, than in Western Europe, these two requirements are organi
cally related in the same fashion as the chicken and the egg: it is impossible to tell which
must be done first. Economic recovery in Germany, which is discussed more fully in subsection C (2) below,
is both a necessity for the development of political leadership and a prerequisite to it. As
in Italy, adequate administrative machinery needed to achieve effective distribution of coal
and food, which is in turn needed to stimulate production, cannot be established without
a broad basis of political support from among the moderate parties. Effective cooperation
of responsible German leaders cannot be obtained unless the latter see hope ahead for a
continued improvement in the economic situation which warrants them in cooperating with
the occupying forces for the benefit of the electorate to which they must appeal. At the political level, the core of
the present difficulty in developing effective non

communist leadership in the bizonal area lies in the fact
that the British and American military governments appear to be more concerned with maneuvering for position between left of center (the British socialists) and right of center (the American Christians) than they are with developing a common ground from which all moderate parties can take a firm stand against the extremes of Nazi and Communist thought. Internecine warfare among the middle groups tends to polarize political thought in Germany rather than to develop cohesive central leadership which will draw support away from the extremes. In the political sphere, the solution to the twin problems of economic recovery and the provision of German leadership lies in a compromise between British support for the SPD and American support for the CDU separatists. Excessive concern by the US for decentralization in economic matters, for free enterprise, abolition of controls, etc. must give way to a real attempt to find a genuine middle ground. The present attempt to build a top-heavy structure providing checks and balance as between the Socialists and Christian Separatists will, if carried to completion, defeat the entire program. The development of centripetal political forces in Germany to replace the present centrifugal forces is the primary task of British-American policy in Germany and one which is not now being met. It is not clear that Germany is ready to respond to an appeal which goes beyond this level and asks her to take a role in the reconstruction and economic recovery of Europe as a whole. The depths of self-pity in Germany are still
being plumbed. The Germans are still too intimately concerned with their own sufferings and are unaware of the existence of comparable economic problems elsewhere. Moreover, such slogans as the "integration of Western Germany into Western Europe" are interpreted by the Germans in their current mood as the granting of license to France, Belgium and Switzerland to use German resources for their own benefit without corresponding benefits to Germany. The temptation lies in the other direction to appeal to German nationalism. The Soviet Union has already embarked on this course of propaganda by supporting at Moscow strong central government and opposing dismemberment of Germany in the West. The United States has attempted to compete as a champion of German nationalistic sentiment in calling for the revision of the German boundary with Poland. If our European program is to take a Europe-wide approach to European economic and political recovery and to fit Germany into the European pattern, German nationalism cannot be emphasized except at the cost of awakened fears in the other European countries.

While for the moment it is impossible to stimulate any interest in Germany in the community of European nations, it may ultimately be possible to do so when more effective and responsible leadership in Germany has been developed on the basis of a progressive amelioration of economic conditions. During this period, the gains to be derived from competing with the Communist Party for the role of champion of
pan-Germanism are probably outweighed by the damage which will be done to the prospect of a European-wide com

munity of interest. There is then little that can be done for the moment to stimulate the Germans to take an active role in the development of a European political and economic recovery. Germany should be brought along with this development rather than pushed into the vanguard. The task of preparing a basis for responsible political leadership in Germany, however, is suffi ciently challenging in its own right and is in any case a prerequisite to tying that leadership into a broader European economic and political framework.

C Raising the Mass Living Standard of Europe

To raise the mass living standard of Europe (which, as we have seen, is a prerequisite to obtaining a favorable European settlement with the USSR) requires a European Recovery Plan buttressed by United States financial and commodity assistance and by United States economic policy in Germany. Drastic improvement of internal economic policy and admin istration in France and especially in Italy will also be essential.

(1) The European Recovery Plan

The political role of a continent-wide European Recovery Plan, as a symbolic goal to strengthen left-center leadership in non-communist Europe and to recreate hope for the future, has been discussed above. It is the purpose of the following paragraphs to explain the economic necessity for such a plan and to describe in
(a) THE ECONOMIC CASE FOR A COORDINATED EUROPEAN RECOVERY PLAN

In economic terms, the heart of the European problem is inadequate production, and resulting shortages, caused primarily by the war and its aftermath. These shortages of almost every conceivable type—food, fuel, raw materials, transportation, industrial equipment and of foreign exchange, especially dollars—constantly harry the economic officials of all major European countries. Some of these shortages are due to over-all supply limitations in a specific commodity (e.g., cereals, coal) perhaps aggravated by an unprecedented demand (e.g., lumber). Others even more difficult of solution are due to the generally depressed levels of all production and to disruption of the normal production and trade patterns of the European economy (e.g., foreign exchange). In response to the pressures of these shortages, decisions are being made and conditions are being allowed to develop within the too limited framework and outlook of national economies which are distorting the pattern of European production and trade and in general are preventing a maximum effort to achieve recovery of Europe as a whole. To give only a few of the most striking examples:

(1) The US and UK occupation authorities in Germany have funneled most of the foreign trade of the bizonal area through the German ports of Hamburg and Bremen in order to save foreign exchange. This step was taken even though Dutch and Belgian ports had handled a large share of German trade for hundreds of years and are admittedly the lower cost route and the natural entrepôt for the Ruhr and
Rhine industrial areas.

(2) The Czechs are threatening to divert their overland carrying trade from its normal routes via the North German ports to some less efficient outlet such as the Polish ports because they cannot afford to pay rail freights in dollars at the rates requested by the United States occupation authorities in Germany.

(3) Exports of forest products from the Scandinavian countries are below prewar, in spite of a desperate European housing shortage, because the coal shortage forces an uneconomical use of timber as fuel.

(4) The coal mines of Britain and France are short of labor although there are 2,500,000 unemployed in Italy and unknown numbers of Germans are hindering recovery in the bizonal area by supporting themselves in the black market and in other non-productive activities.

(5) An already over-burdened railroad system is forced to carry Polish coal across the continent from the Silesian mines to France and to haul Ruhr coal in the opposite direction to Berlin.

(6) Italian, Dutch and Greek vegetables and fruits cannot be marketed and are left to rot in a continent where almost everyone has a vitamin deficiency.

(7) The conduct of most intra-European trade through bilateral clearing accounts narrows the marketability of all but the most highly essential materials and products. Exporters of less essential goods are forced to accept very disadvantageous trade terms in order to obtain needed imports, although much better terms could be obtained from third countries. Conversely, an importing country is forced to accept in payment goods of limited usefulness to its economy but badly needed in third countries.

(8) Limited supplies of German steel are used to manufacture cameras and toy trains for export to the United States rather than milking machines to increase Danish and Dutch dairy production or desperately needed spare parts to increase the productivity of undermaintained European machines.

(9) Almost every country in Europe has or is developing a two, three, four or five year recovery plan, but there has been almost no coordination of these national plans to determine whether they make sense in relation to each
other. For example, France, Luxembourg, Czechoslovakia and Poland are all asking for credits to develop steel production. The bizonal authorities in Germany are planning a large revival of Ruhr steel output. There may well be waste which Europe cannot afford unless there is a coordinated continental steel program, geared to total European coal availabilities, which is designed and administered to meet the end uses most essential from a general European viewpoint.

Perhaps the most striking single example of national economic policy pursued without regard for the interests of European recovery as a whole is the failure of the United States and British occupation authorities to raise production in Germany and to orient that production (and the German market) in part toward the needs of Europe. Some of the complex ramifications of this issue are discussed in subsection C(2) below. After a fast start during 1946, European recovery has slowed down, with over-all production, both agricultural and industrial, and exports still well short of prewar levels. The two most important limitations are still food and coal supply; but, as had for some time been foreseen, the almost totally uncoordinated nature of national economic policies, of which the above instances are illustrative, is now becoming an increasingly important brake on recovery. As long as production and trade were at very low levels, national (and even local) efforts to break immediate and clearly defined bottlenecks were adequate and effective. As production approaches the general limitations set by present plant capacity and/or manpower, however, the highly specific type of bottleneck tends to disappear, and a continuation of rapid recovery becomes dependent on a conscious attempt to rebuild the complex and delicate pattern of intra-European production and market relationships which
were disrupted by the war. Dollar resources in Europe are now running very low. But the American people and the Congress are understandably reluctant to commit themselves to further financial credits which simply keep individual countries afloat without any assurance of putting an end to the strain on the taxpayers' pocketbook. To give them such assurance, what is needed is a European Recovery Plan which will:

(1) provide a renewed impetus to production and recovery;

(2) maximize the intra-European trade and production potential;

(3) cover all countries requiring aid;

(4) provide satisfactory assurances of enabling Europe to stand on its own feet in a reasonable period of time;

(5) provide a definite limit, both in time and amount, to the expenditure of United States funds;

(6) achieve recovery in the shortest possible time and at the lowest possible cost to the United States.

(2) Economic Recovery in Germany [pp. 58 ff. of original memorandum]

As the most important industrial power in Europe and the area where US and Soviet political aims and substantive actions are most closely joined, Germany is of crucial importance for the attainment of our two long-run objectives in Europe. It is in Germany that the feasibility of practical cooperation with the Russians will be finally determined. As we saw above, it is Germany which must be the principal subject of the European settlement which is the short-run objective of our European policy. And it is on Germany that the suc
cess of the European Recovery Plan recommended in this memorandum in large measure depends.

(a) ORIGINAL PREMISES OF UNITED STATES POLICY IN GERMANY

The German policy of the United States immediately after unconditional surrender was in large measure based on the first of the long-run objectives of our foreign policy: the attempt to find a basis of accommodation with the Soviet Union. Since the substance of contemporary Soviet policy toward Germany was in harmony with large segments of American opinion as to the proper treatment of that country, such a basis of accommodation at the time appeared to be readily attainable. There were, to be sure, major elements of purely German policy involved: the drive to punish the Germans for the evil they had done; the desire to restrain them economically, partly for fear that their powers of recuperation would prove stronger than those of the rest of Europe, and partly for fear of future aggression: the purely negative determination to avoid the mistakes of the German policy of the First World War. Underlying all this policy, however, was the view that Germany’s most appropriate penance for her sins of aggression would be to serve as neutral ground between East and West where negotiation and compromise would provide a basis for adjustment. Thus American support for reparation removals of industrial equipment sprang partly from the objective of disarmament, and partly from
the search for a formula which would avoid the necessity for American financing of reparations. The final impetus to acceptance of the removals plan was given, however, when it was found that it had already been put into effective, if unplanned, operation under the aegis of the Soviet Army; and that, as a result, no other basis existed for a reparation agreement acceptable to the Soviets. In this concentration on German policy primarily as an instrument of accommodation with the Russians, and secondarily as an instrument of punishment and restraint, such attention as was devoted to general European problems was largely negative. The liberated countries were to be protected against a surge of German economic recovery which might impede their own reconstruction, and against the possibility of future German aggression; and they were to receive such items of capital equipment the removal of which from Germany was deemed necessary for disarmament. Small heed was given, however, to the possibility that Germany might make a major contribution to European recovery.

(b) THE SHIFT IN PREMISES

Two years of frustration in attempting negotiation with the Soviet Union have produced in many quarters an attitude of mind based almost solely on the second of our long-run objectives: the attempt to secure strategic advantages to improve our chances of winning a possible war with the USSR. Thus Mr Hoover, for example, pays
lip service to certain aspects

of present German policy—to denazification,
democratization, demilitarization, etc.—but

hits hard at all restrictions of an economic character,
including particularly the notions that

the recovery of Germany should be slower than that of
liberated countries, that Germany

should pay reparation, and that German cartels should be
eliminated. Two years of continuing and heavy American
financial contributions to the support of

Germany have produced an almost equally widespread attitude
of mind which concentrates

on the necessity for making Germany a paying proposition.
In certain quarters this urgent

desire to get the Germans off relief virtually obscures the
fact that nearly every other coun

try in Europe is also living on credit, and obscures also
the possibility of the resurrection of

a powerful Germany, waxing strong on the competitive favors
of East and West. The quadripartite frustration and
continuing financial deficits described above have, in

combination, proved a powerful stimulus to re-examination
of the original premises of

United States policy toward Germany. The original aim of
finding a basis for accommoda

tion with the Soviet Union has been retained, however
dimmed the original hopes, but to it

has been added the second aim of securing strategic
advantages for possible eventual war

with the Soviet Union. With the diminished emphasis on
placating Soviet suspicions and

fears to the utmost, it has become possible to devote
increased attention to the implications

which German policy holds for general European policy, and,
conversely, to the bearing of

certain European policies on German policy. It has been found, for example, that measures aimed at the full or partial reconstruc
tion of the German economy, which might in some quarters be advocated as a means of
securing strategic advantages against Russia, or as a means of reducing the United States
contribution to the support of Germany, might also serve the reconstruction of Europe.

Thus it has become apparent that large-scale dismantling of the German machinery indus
try would leave Europe poorer in machinery production—at least for the extensive period
of time necessary to transfer plants as reparation and to restore them to operation. It has
also become clear that the drive to secure coal for Europe from German mines cannot be
pursued to the point where no coal remains for German consumption. The German prob
lem has increasingly come to be seen not merely as a Russian problem, but as a European
problem. Present United States policy toward Germany, therefore, is a curious amalgam. It retains
strong elements of uniquely German policy: demilitarization, disarmament, democratiza
tion, decartelization, etc. In addition, however, it now regards Germany as an important
part of Europe, with repercussions of United States policy in Germany flowing from that
country into all parts of Europe. Like all United States foreign policy, policy in Germany is
of necessity afflicted with the schizoid attitude toward the Soviet Union: solidarity forever
if at all possible, but a well-protected flank if not. Finally, like all United States policy in all fields, German policy aims at achieving its objectives with the least possible expenditure of United States funds. No one of these four strands of policy, however, predominates over the others.

(c) AGREEMENTS EMBODYING POLICY

The Potsdam Agreement embodied fully the original premises of United States policy toward Germany. Its basic economic provisions for Germany were: (a) the restriction of the level of industry to 50 to 55 percent of that existing in 1938; (b) the removal as reparation of all industrial equipment in excess of this permitted level; and (c) the agreement that Germany should be operated as an economic unit, with pooling of economic resources and expenses without regard to zonal boundaries. The Level of Industry Agreement of March 1946 represented the closest approach to quadripartite fulfillment of these economic provisions. General Clay’s stop-order, in May 1946, on further dismantling of plants for reparation purposes, pending the achievement of economic unity, represented the first overt recognition of the failure of Potsdam. The US-UK Agreement of December 1946, for the economic fusion of their two zones in Germany, with the aim of achieving economic self support for the area within three years, marked the final recognition that the likelihood of
the Soviet Union’s carrying out the Potsdam contract for economic unity was remote. Insofar as it was related at all to United States policy, the reparation stop-order represented in large part purely German policy, a desire to retain in the United States Zone sufficient resources to compensate for possible failure to achieve economic unity, and thus to avert a possible increase in the American taxpayer’s contribution to German support. The agreement for the fusion of the US and UK Zones likewise represented in large measure the desire to make Germany self-supporting, although there was additional rationale concerning the attractive effects the fusion would exert over the other zones. Except for the special case of coal, it was not until the Moscow meeting of the Council of Foreign Ministers that the policy of regarding Germany as a part of Europe was embodied in international agreements concerning Germany. At the Moscow session a number of decisions were taken, for the most part outside the normal quadripartite business of the Council, which have affected US-UK economic policy in Germany. The four powers agreed in principle to increase the level of industry to be left in Germany after reparation removals; and the Secretary of State and the British Secretary of State for Foreign Affairs agreed to go forward with the calculation of a revised level of industry for application to the combined US-UK Zones. In the statements on the subject by the United States Delegation, the major basis for revision was given as the necessity to retain in Germany sufficient industrial capacity to
produce goods required, not only by

the minimum peacetime German economy, but also by European
countries which could

purchase them from Germany on commercial terms. British
acceptance of this basis of

revision has been tacit rather than explicit. The thought, however, that the peacetime com

mercial requirements of Europe for German goods should be
taken into consideration in

the determination of the level of industry to be left in
Germany, represents a sharp depar

ture from the criteria of the Potsdam Agreement, and a step
toward treating the German

economic problem as a part of a wider European problem. The
United States, Britain and France, moreover, reached at
Moscow a new agreement

on coal exports from Western Germany, superseding the
tripartite coal directive of July

1945. The early directive called for the export of 25
million tons of coal from Germany
during the last five months of 1945 and the first four
months of 1946, without requiring the
retention in Germany either of an absolute amount or a
particular percentage of German
coal production. German coal production never reached a
sufficiently high level to permit
the directive to be carried out. The Moscow Agreement, which governs the last six months
of 1947, provides for a sliding scale under which gradually
rising proportions of net mer
chantable coal production are to be exported as total coal
production in the Ruhr and Saar

increases. Germany is therefore permitted to retain an
increasing absolute amount of coal
for her own use. Thus, in conjunction, the agreements reached at Moscow mark the consummation of the shift in premises from the days immediately after the war when Germany and liberated Europe were regarded as separate problems. Both the new coal agreement and the new level of industry agreement recognize that conflicting German and other European needs must be resolved on a mutual basis.

(d) CURRENT ECONOMIC CONDITIONS IN GERMANY AND EUROPE

The changes in policy, and the corresponding changes in international agreements described above, have taken place against and been conditioned by a background of economic conditions in Germany and the rest of Europe which have fallen progressively below the sharp upward trend which was anticipated two years ago. Industrial production in Germany is only 45 percent of the 1936 level, although total industrial capacity is undoubtedly much higher than in 1936. Coal production in the Ruhr is only slightly more than 50 percent of prewar. Food consumption in urban areas still hovers around and below the disease and unrest level. Distribution of all products is chaotic, and economic remedies are in large measure impossible to enforce. Yet the state of Germany, commonly referred to as economic prostration, represents only a more acute version of that of the rest of Europe. All industrial areas of Europe are gravely short of food and coal, and of raw materials, and these shortages impose a tight brake on
general industrial production. Not only Germany, but all European countries are dependent on United States dollar credits for a critical proportion of the food, materials and equipment needed to keep their economies running on a mere maintenance basis. Nor is the prospect in sight that this dependence will cease within the near future. The basic causes of Germany’s state of chronic collapse, reflected in varying degrees in other European countries, are partly political and partly economic. Most fundamental and general, overshadowing the more specific causes, is a failure of organization and will, a failure which is so acute that even the most elementary economic remedies cannot be made effective. Despite the lack of coal for the most urgent use, it is known that a substantial fraction of the coal retained in Germany disappears into the black market. The population of Bavaria puts on weight while the search of Ruhr miners for black market food sends the absenteeism rate up to 33 percent. There exists in Germany neither an effective administrative apparatus for enforcing unpopular decisions, nor a political structure for enlisting the support of the bulk of the population behind the economic goals which are essential for the good of the community. Under the conditions of low-level production and consumption which dominate Germany today, the apparent immediate good of the individual is sharply and continuously in conflict with the general good of the community, and no effective means for harmonizing
or suppressing this conflict are at hand. Under these conditions, the entrepreneur is interested in production primarily for the repair and maintenance of his plant, but not for the community interest. The worker concentrates attention on the maintenance of himself and his family, as against output which would benefit the community as a whole. In the face of this basic and uncontrolled conflict of motives, the other causes of Germany’s economic stagnation seem secondary. The retention of a greater amount of the Ruhr’s coal production for use in Germany would undoubtedly improve industrial output; but the first step must be to ensure that the coal already being retained is put to effective use. A large increase in rations for the Ruhr miners would undoubtedly increase coal output; but, unless effective steps can be taken to ensure the equitable distribution of the food produced by German farmers, such an increase could be made only at the cost of the American and British taxpayers. Lack of economic unity, the necessity for financial reform, lack of funds for the importation of raw materials, uncertainties created by the prospect of reparation and restitution, disturbances due to denazification, etc.: all these are contributory obstacles to German production. Unless accompanied by fundamental administrative and political reform, however, the overcoming of any or all of the obstacles could provide only a temporary and limited stimulus to German recovery.

(e) BASIC UNITED STATES POLICY TOWARDS ECONOMIC RECOVERY IN
The United States desire to promote economic recovery in Germany rests on four strands of influence noted in the discussion of the basic premises of United States policy: the aim that Germany should become a democratic, peaceful state; the aim of securing in Germany both the possibility of cooperation with, and strategic insurance against, the Soviet Union; the aim that Germany should contribute to general European recovery; and the aim of minimizing American expenditures. It is, for example, agreed that democracy cannot take root in Germany if the Germans are unable to fill their bellies. It is considered that the most effective means of achieving economic unification of the four occupation zones of Germany is to make the bizonal merger of the British and American Zones an economic success, since the Russians cannot afford to keep the Germans in the Eastern Zone out of a success. The restoration of German trade is important to Europe as a source of goods and an outlet for surpluses. And finally, economic recovery would make possible the stoppage of United States appropriations for feeding the Germans. Economic recovery is easily chosen as an end of policy; its attainment, however, or even agreement on the means for attaining it, is less easy. Prescriptions are practically as numerous as doctors. It has been suggested that to restore industrial activity in Germany we need:

(a) more centralization; (b) abandonment of the policies of denazification and decarteliza...
tion; (c) abandonment of the level of industry plan and reparation out of capital equipment (the Hoover nostrum); (d) large-scale imports of capital into Germany; (e) retention of scarce commodities by Germany, such as coal, lumber, potash, etc.; (f) increasing German consumption in all lines; (g) over-riding priorities for production of critical items, such as food, coal and exports, etc., etc. These conflicting views reflect the conflicts inherent in the four basic premises of United States policies; the reconciliation of such of them as merit serious attention must be a question of emphasis and timing. These conflicts may be illuminated by the sharp contrasts between British and American policy toward German recovery which existed prior to the fusion of the two zones, and which still vex bizonal negotiations. Most basic is the question of the proper political and administrative organizations of Germany—centralization vs. decentralization. The British have wanted strong central economic agencies, heavily staffed with both German and Allied administrators—the Germans to bear the full responsibility, and the Allies to exercise final authority. The Americans have stood for decentralized agencies, operating through the eight Länder governments and with checks and balances of the American variety for the reconciliation of differing German interests. Neither system has proved capable of dealing with the problems of modern government in a prostrate economy such as Ger
many's today. Government in the British Zone is weak because administrative agencies are top-heavy and muscle-bound, teeming with bureaucrats and face to face with a long line of British administrators who must approve each action at each step in its development. Capable and honest Germans refuse to work in such a set-up. In the American Zone, government is weak by design. The Laender meet as equals: action can be taken only by unanimous consent, plus the endorsement of military government. The result of weak government in both zones has been economic chaos, with the black and gray markets absorbing large fractions of the scarce commodities on which recovery depends. The wartime experiences of all belligerent countries, including the United States, demonstrated conclusively that the price system cannot be relied on for equitable and economically effective allocation of critical goods in short supply; yet the black market price system now governs by default large segments of the German economy. There can be no doubt but that strong, central control is an essential prerequisite to the economic recovery of Germany. A second important conflict between American and British recovery policy has been over the question of economic priorities. In the American Zone, overriding priorities have been given to coal, transport and food, in the conviction that recovery in these fields would automatically bring with it more general recovery; and that concentration of effort is essential to success. In the British Zone, however, an attempt
was made to re-activate the entire economy at once. The Ruhr economy collapsed in the spring of 1946 and again in the winter and spring of 1947. Scarce building materials were shared so widely that progress was equally slow in all areas, and only 2 percent of the available supply went to miners’ housing. It seems clear that this diffusion of effort in the British Zone has defeated its own ends. It is believed that it is impossible to achieve economic recovery in Germany except by strict and overriding priorities for the key sectors of the economy, and allocations of all needed goods to their most critical uses, at whatever cost (within practical limits) to the rest of the economy. A third difference of principle, related to the foregoing, is found in contrasting British and American attitudes toward exports and imports. In the British view the critical problem of the German economy is not effective administration, but general shortages of all types of goods. The British therefore tend to suggest that the German need for German production of coal, steel, machinery, etc. is more acute than that of other countries; and that, indeed, there should be a substantial expansion of imports into Germany. Exports are crucial to Germany; imports are both warranted and essential. To the American group, exports are a necessity (to reduce the cost of feeding the Germans at a pace at least as fast as Congressional appropriations are likely to be cut); and imports, unless needed to produce exports,
are anathema. The practical reasoning of the American representatives is compelling of itself. As a matter of principle, however, it may be added that American aid to any country will be wasted if it is received without concurrent attempts by that country to use its own resources and outside aid to make itself self-supporting. Finally, some attention should be paid to the suggestion that reparation removals of capital equipment from Germany are impeding recovery. This suggestion is regarded by most experts as nonsense. The Level of Industry Agreement of March 1946 was subject to criticism, since it fixed a level which was too low in relation either to Germany by itself or to a Germany bound in intimate trade ties with Europe. But the suggestions that the German war economy is an appropriate economy for a peacetime Germany (aside from factories producing final armament products), and that a reduction of German steel capacity from 21 million tons per year to 12, 19, or million prevents current output from surpassing 3 million tons a year, cannot be accepted. Some reparation must in justice be paid by Germany to the countries it warred against. To deliver to these countries capital equipment which the Germans used only for war-making is both good German policy and good European policy. In conclusion, it should be stated that appropriate United States policy for economic recovery in Germany must suffer the handicaps of other strains of United States policy—democratization, decartelization, reparation, and
restitution, general European recovery,
keeping US expenditures to a minimum, etc. For the immediate future, it should concentrate on:

(1) The development of adequate administrative machinery in Germany capable of carrying out a program of overriding priorities for production of food, coal and exports, and of preventing the diversion of these goods into wasteful German consumption.

(2) The maximization of productive effort on a few key items of the German economy—food, coal and exports—by giving them the highest priority in claims on managerial ability, on labor and on goods.

(3) Channeling the maximum proportion of German production into the export markets, and keeping imports to the minimum. (In view of the increasing reluctance of British and American taxpayers to contribute to German support, this development is essential to German recovery.) It is possible that, when in the more distant future general European production and consumption have reached adequate levels, a more general program for German economic recovery will need to be developed, a program calling for heavily increased German production and consumption in all fields. To initiate such a program now, however, at a time when European recovery is critically dependent on German production of coal and other goods, and when the American contribution to German relief is faced with reduction rather than expansion, would be self-defeating. There is no likelihood that the American funds necessary to support such a program would be forthcoming. Without such support, the program would fail in Germany through diffusion of inadequate effort; and would seriously
retard the recovery of other European countries.

(f) GERMAN RECOVERY IN RELATION TO EUROPEAN RECOVERY

It is evident that United States policy toward Germany’s economic relation with other European and foreign countries will differ according to the extent to which German recovery is sought by itself, or as part of a general program of economic recovery for Europe. In neither case can the United States allow other European countries to be subsidized by Germany, or, more accurately, by the United States through Germany. At the same time, choices must be made concerning the pattern of production and consumption in Germany, the proportions and types of goods to be exported, the countries to which German exports should be sold and from which imports should be purchased, and the currency in which payment for exports should be made. One of the most important examples of the choices which must be made is found in the urge of American officials in Germany to expand exports and restrict imports, a policy which tends to take a form peculiarly German—and anti-European—in orientation. The utmost in value should be exported. Coal should be retained in Germany in order to produce exports worth three to four times as much, since they embody German labor. (European countries, however, need coal from Germany in order to employ their own idle labor in plants which cannot get coal from other sources.) For the same reason, lumber should
be manufactured into radio cabinets for sale in the United States, rather than into floor sections for housing reconstruction in France. Conversely, the most extreme lengths should be gone into to avoid imports. Thus Bremen and Hamburg should serve as ports for the Ruhr and Southern Germany, even though Antwerp and Rotterdam lie on the direct routes from overseas, since the use of Rotterdam and Antwerp costs foreign exchange. Another aspect of the same problem is presented by the shortage of dollars in Germany and throughout Europe. The bulk of the expenditure for aid to Germany is made in the dollar area, partly as a matter of necessity and partly because of administrative convenience and inertia. This suggests to officials in Germany the desirability of attempting to collect for the proceeds of exports in dollars, and of manufacturing goods for the dollar market regardless of the needs of neighboring European countries. Hence an attempt is made to collect dollars for transit traffic across Germany to and from Czechoslovakia, despite the fact that Czechoslovakia claims that she has no dollars to pay with; and to sell soda ash to Libbey-Owens-Ford in Illinois for the manufacture of plate glass, rather than to Belgium, which needs soda ash to make milk bottles. The requirement that dollars be paid for German exports has been watered down in practice from its original bare character. Clearing agreements were established with European customers of Germany, with purchases and sales offset currently and only unpaid bal
ances settled in dollars every six months. Moreover, under the bizonal fusion, settlements could be made in dollars or sterling, with the UK undertaking to convert sufficient sterling into dollars to maintain the bizonal agency’s buying power for essential raw materials in dollars. Despite these economic concessions, however, the fact remains that German sales to Europe are handicapped by the dollar requirement lurking below the present payments arrangement; and that strong pressures continue to exist in Germany both to manufacture goods suitable for dollar sales rather than goods required in Europe, and to prefer American to European sales of identical products. If it be agreed that Germany should export to the limit, the question remains what she should export, to whom, and in what currency. And if it be agreed that Germany must be economical in importing, the question still requires answer whether normal and constructive trade relationships in Europe should be altered to save foreign exchange. The possibility exists that German policy could be modified from its present rigid cast if US policy in Germany were to be merged into US policy in Europe. It is evident that the answers to these questions depend partly on the policy pursued regarding relative rates of economic activity. The United States has in general adhered to the policy that economic recovery in liberated areas should take precedence over that of Germany, although a number of the detailed United States policies in Germany, noted
above, are in fact in conflict with this policy. The time has perhaps come when, without halting the recovery of the liberated areas, it is appropriate to allow German industrial activity to begin to catch up more rapidly; and it is possible that such a policy, if pursued within the framework of a European program, would make a more substantial contribution to general European recovery than does the present restrictive and confused one. These manifold relationships of German to European economic recovery have been explored as far as possible in a general paper of this character. The conclusions that can be drawn must be equally general. The major conclusion must be that all United States policies for German recovery should be tested not only according to their contribution to recovery in Germany and to the reduction of the United States financial burden in Germany, but also according to their contribution to European recovery and to the reduction of the United States financial burden in Europe generally. So long as no general European recovery program exists, this is a difficult test to apply. As a prima facie test, however, it may be taken that any German policy which tends seriously to distort constructive prewar trade relationships, or to restrict general European trade opportunities, is a bad policy. There may be compelling reasons of finance or politics which make the adoption of such a policy unavoidable, but they should be subject to the sharpest scrutiny. Perhaps an effective way to reduce the dollar barrier to German trade in Europe would
be to incorporate in any program of American aid to Europe a credit which would be available only for imports from Germany. The sum of, say, 2 billion dollars might, for example, be allocated to the European aid program but assigned not to one country, but in small amounts to such countries among a stated list as wanted to buy goods from Germany on credit. The debts would be owed to the US by the importing country. Germany would receive the funds only as goods were produced and sold by her to Europe. German trade in Europe would be stimulated, however, and the dollar barrier to purchases from Germany would be substantially lowered. An arrangement of this sort would be administered through the European clearing agency suggested in subsection C (1) above [not included in present volume]. It could be combined with an adjustment in the export price of German coal, now too low. It would also have the advantage of suggesting the European-wide character of the recovery which the United States seeks. From the side of Germany, it might well prove that a bizonal recovery plan which explicitly recognized the needs of Europe, and which related the planned pattern of German production, exports and imports to those needs, would act as the effective catalyst to the formation of a European recovery plan. Such a bizonal recovery plan should be limited in scope, concentrating on key sectors of the German and European economies. It is believed, however, that sufficient information is now at hand to
permit the formulation of such a plan.

Neither the dollar problem nor the production problem can be solved without the economic unification of Germany and of Europe. Note

1 See, for example, UN Subcommission on Economic Reconstruction of Devastated Areas, Report, pt. 3, ch. 3, July 1946.
2 1948 Memorandum for the Files: Origins of the Marshall Plan


The collection of gossip and rumors presented below is not vouched for in any way. It is set forth only because time is fleeting, memories fade, and the stuff of history is fragile.

Even at this date, thirteen months later, I am unable to sort out what I know of my direct knowledge and what I have been told. 1 It is well known that the topic of European reconstruction was widely discussed during the winter of 1946–7. The Council on Foreign Relations had its entire winter program devoted to this topic. I talked twice on it: once in January on coal; and a second time in May on Germany. Walter Lippmann, 2 without claiming credit for the origin of the Marshall Plan, has told me that he wrote a series of columns (not the one on the cold war) setting forth the necessity for a plan for European reconstruction. This I do not recall and didn’t when he told me. In early 1946, Walt Rostow 3 had a revelation that the unity of Germany could not be achieved without the unity of Europe, and that the unity of Europe could best be approached.
crabwise through technical cooperation in economic matters, rather than bluntly in diplomatic negotiation. This suggestion was given to Secretary Byrnes for free examination through the kindly offices of Mr Acheson. Joe and Stewart Alsop 4 wrote a column on the subject in April 1946, referring to what was in the Secretary's briefcase. In any event, the Secretary didn't buy. That summer, however, the US representation on the Devastated Areas Subcommission of the Commission on Employment of ECOSOC (the Economic and Social Council of the United Nations) bought the idea from Rostow and Kindleberger (who was at that time a member of the firm) and peddled it first to Mr Lubin on the Commission on Employment, to the Poles and to others. This was the origin of the Economic Commission for Europe (ECE), of which causa proxima was Mr Molotov's 5 decision, made in the corridors of the Waldorf after a midnight debate between the Poles (winners) and the Jugs (losers). The ECE thought was inextricably wound up in a European recovery plan. ECOSOC in February 1947 wrote terms of reference for ECE (it thought it did; actually Miriam Camp 6 wrote the terms of reference and ECOSOC initialled them). These contained reference to planned recovery programs. I have had a hard time seeing how the Acheson speech at Delta, Mississippi, was the midwife to the Marshall Plan. Acheson made five points—including primarily the usual ones about multilateralism which the Department has stated
so frequently that it is inclined
to believe them. One point, however, referred to using
United States assistance in future
where it would do the most good in recovery in some planned
way. This was hardly revolu
tionary, since there was no specific suggestion of a
recovery program, and since there was
no suggestion as to who should draw one up. And the point
was only one of five. In my book, Scotty Reston 7 gets a
great deal of the credit for initiating the Marshall
Plan. As I reconstruct the plot, Reston would have lunch
with Acheson. Mr Acheson, as
many of his warmest admirers are prepared to concede,
converses with a broad brush. Res
ton would get him started on European recovery, and Mr
Acheson would allude to plans
under consideration. The following day invariably Reston
would have a first-page story in
the New York Times referring to big planning going on in
the State Department. This would
give Mr Kennan, who had just been appointed to the newly
created planning staff in Febru
ary, the jim-jams. If there was public talk of all this
planning in the Department, and the
planning staff had received so much publicity, maybe this
was where the effort should be
applied. As I say, I have no way of knowing what was going
on in Mr Kennan’s mind. I do
recall, however, learning that Kennan had been having lunch
with Reston (this may have
been later though). Perhaps Reston was acting as liaison
man within the Department. The Secretary got back from
Moscow in April—about the 25th I recall. The Truman
doctrine was making heavy weather of it, both on Capitol
Hill and in the country as a whole. Its negative, retaliatory, counter-punching features were disliked. Its implications for economic and ultimately military warfare were regretted. I had the strong impression from a chance conversation with Willard Thorp before I left for Moscow on 20 February (about), that the Department was in a panic as to what to do in Greece. Slapping together an anti-Russian policy to take over the British policing role there, was too much for the country to swallow. It gagged. The Secretary, whose attention to the Truman message of 11 March 8 must have been cursory at best, was obviously going to try something else. The Truman doctrine was no great shakes. Negotiation in the CFM was no way to get peace fast. He was receptive to new ideas. Then Mr Clayton came home from Geneva. I do not remember when he did return, but it was either April or May. It was common knowledge in the Department that Mr Clayton was deeply exercised by what he had seen in Europe. He had the impression that Europe was collapsing rapidly. His interest lay in production—and he was deeply impressed by the prospective failure of the French wheat crop—and in organized markets. He was depressed by what he had seen and heard of black markets, hoarding, etc. He was worked up about the state of the economy of Europe and felt strongly that something should be done. About this time, partly I guess in response to the Reston articles, Van Cleveland and Ben Moore started to write a long memo on a European recovery program. I was asked to
contribute a couple of chapters on Germany, which I did. Cleveland and I had some dif

ficulty getting together on the German passages. He felt that what I had written did not fit

into his broader scheme, and I would not accept what he rewrote of my material as bearing

any resemblance to the economic problems of Germany or their solution. This memo was

finished sometime before the end of May, as I recall. It took a long time to duplicate in

mimeograph. This was finally done and it appeared after the Harvard speech with a date of

12 June 1947. 9 During April or May, Ty Wood 10 organized the Thursday luncheons in the Assistant Sec

retary’s office for office directors. The purpose of these was to discuss wider problems of a

sort a little too vague to warrant holding meetings for. Ed Martin 11 tells me that the Thurs

day meeting began to discuss the European recovery problem during May. It had, of course,

heard from Mr Clayton. It was, moreover, aware that Cleveland and Moore were writing the

piece on a recovery program. Some of the May discussion turned on how to organize the

shop to deal with the problem of European recovery. Bill Malenbaum 12 tells me that on 3 or 4 June, but in any

event just before the Harvard speech, Mr Wm. A.Eddy, Special Assistant to the Secretary for Intelligence, told him that

the Secretary had called a meeting at the assistant-secretary level to discuss the proposed

speech and that there had been a fundamental difference of opinion between Clayton and
Kennan as to how to go about the European recovery program. This difference, of course,

turned narrowly on how to write the speech. But it may be useful to turn first to the drafting

of the speech. On no good authority, and I have forgotten what, I have understood for some time that

the speech is a merger of paragraphs from separate memos on the problem of European

recovery written by Mr Clayton and Mr Kennan. The part laying out the analysis of what is

wrong in Europe seems to be very much the product of Mr Clayton’s mind. The emphasis

on trade and exchange is striking. The rest, and particularly the final paragraphs, are sup

posed to be the product of Mr Kennan’s pen. The question which apparently divided Messrs Clayton and Kennan was that of whether

the initiative should be left to Europe. Mr Clayton, as I later learned from him, was strongly

opposed to a program of the UNRRA type, where the United States put up most of the

funds and had only one vote in 17 on its distribution. He was accordingly opposed to reduc

ing the role of the United States to that of supplying the assistance. It seems to me probable

that his opposition to a European plan for US assistance sprang from this background of

view. Mr Kennan, on the other hand, presumably had in mind the political desirability of

leaving the initiative to Europe. The clash between these views, of course, was ultimately

resolved through the device of the multilateral and bilateral agreements, with Europe oper

ating the program under a series of mutual pledges, but
each country being responsible for

its performance under the program to the US if it received
assistance. Bill Malenbaum also reports that Walter Salant
(sic), 13 who had the task for the Coun

cil of Economic Advisers of estimating the net foreign
balance of the United States for a

period ahead, asked him just before the speech what his
views were on whether there would

be a foreign aid program. Salant said that he had canvassed
the Department of State and

that there was no unanimity of view as to what was about to
transpire, but that on balance

he thought the majority view was that there would be no
program of assistance.

A newspaper man—I forget which one—gave me a long story on
how the speech happened
to be delivered at Harvard which may be worth setting down,
despite the fact that I cannot

vouch for one word of it. First, however, I cannot help
recalling a bit of dialogue which

took place in the central corridor, fifth floor, New State
Department Building, in about the

second week of July between Philander P. Claxton 14 and me.

CLAXTON: Where have you been? I haven’t seen you around
lately.

KINDLEBERGER: I am not working on German matters any more.
I have moved over and now work on the European recovery
program.

CLAXTON: Oh, that’s the program which developed out of the
Secretary’s speech at Princeton.

KINDLEBERGER: Phil, where did you go to college?

CLAXTON: Princeton, why?

KINDLEBERGER: That’s what I thought. According to the
newsman’s unsubstantiated story, the Secretary agreed with Messrs Kennan and Clayton that there should be a speech and that it should read about as it eventually did. He then wondered where it might be given. Pat Carter looked up and found that the Secretary had no speaking engagements until 17 June 1947, which all agreed was too far distant in the future in the nature of the existing European crisis. At that point, the Secretary is said to have remembered that Harvard University had awarded him a degree during the war. He had refused it. Normally, he wrote letters to universities which offered him degrees during the war, saying that he was unable to accept because he felt that the soldiers overseas might misunderstand his position if he were to accept an honorary degree, leaving his desk for the purpose, when they couldn’t get away.

This type of letter could not be written to Harvard, however, since Admiral King and General Arnold had both been awarded degrees and had accepted. Accordingly, the Secretary merely wrote and refused it. It had rarely if ever occurred before that Harvard had been refused an offer of an honorary degree, and the University was both surprised and puzzled. Suspecting, however, that the Secretary had some hidden motive for refusing, it wrote back to him saying that it would award the degree, which the Secretary could claim at any time when it suited his convenience. All this the Secretary recalled. Accordingly, he got in touch with Harvard and said he wanted his degree. This again is reported to have surprised
Harvard, which already had a
speaker and whose commencement, only a few days away, was
practically complete as to
arrangements. But Harvard gracefully acquiesced. And the
historic speech was given at
Harvard. Ed Mason 16 says that he doesn’t believe this
story because, as he puts it, Harvard
does not alter its arrangements even for the Secretary of
State. Joe Harsch of CBS and the Christian Science Monitor
has printed this story as to why
the Marshall Plan should be called the Miall Plan. 17
Leonard Miall is the BBC correspon
dent in Washington and incidentally a neighbor, car-pool
mate and friend of mine. I recall
very well that the evening of 4 June, as we were driving
home, he complained that he had
just finished writing out a script for the next day’s noon
broadcast on plans for United States
economic aid to Europe, when on his way home he had stopped
by the newsroom of the
Department and picked up a copy of the Harvard speech. This
required him to tear up his
script and start again. (It seems to me noteworthy in
retrospect that aid to Europe was such
a widespread thought in Washington that Miall would have
written several scripts on the
subject, starting out with the Acheson Delta speech. He was
fairly close to Acheson, with
whom, along with a group of British journalists, he had
lunched once or twice.) Miall handed me the text of the
Marshall speech in the back of the car. I hastily read it as
the car moved along and suggested that this was big news
and that he would most certainly
have to do a new script. I recall that Miall was irritated as well by the fact that there was no firm release date on the Marshall speech, release being the indeterminate hour the speech would begin at Harvard. This was a usual annoyance for him, however, in booking circuits to London. Harsch’s story runs to the effect that Philip Jordan, the information officer of the British Embassy, asked Mr Balfour, then the chargé, whether he should cable the Foreign Office the text of the Secretary’s speech. Balfour is reported to have said no—just another commencement speech. The rest of the British and foreign press were all off running down some other story which they featured in their cables—United States note to some country like Hungary—if I recall correctly. Only Malcolm Muggeridge of the Daily Telegraph and Leonard Miall of BBC gave it a big play (Harsch omits mention of Muggeridge, but Miall insists he should share the credit). And so the Marshall Plan was communicated to Mr Bevin by the BBC (and possibly the Daily Telegraph) since the Foreign Office-Embassy, London Times and other avenues of communication were uninterested in it. I have many times been asked whether the Department did not advise US missions abroad and/or foreign missions here of the importance which it attached to the speech. As far as I have gathered, without putting any effort into it, the answer is no. Asked why not, I have had no answer. These random jottings are perhaps not worth recording. I record them just the same to help light the lamp of memory for my old age, waiting for
me around the corner. Notes

1 As chief of the Division of German and Austrian Economic Affairs, Department of State, I participated in the work of various departmental and interdepartmental committees on the Marshall Plan.

2 Walter Lippmann, newspaper columnist.

3 Walt W. Rostow, Assistant Chief, Division of German and Austrian Economic Affairs.

4 Joseph and Stewart Alsop, newspaper columnists.

5 Vyacheslav M. Molotov, Minister of Foreign Affairs of the Soviet Union.

6 Miriam Camp, a Foreign Service staff officer in London in 1946, returned to the Department of State in January 1947 as a divisional assistant.

7 James Reston, a Washington correspondent of the New York Times.

8 Presumably the President’s Special Message to the Congress on Greece and Turkey, delivered in person before a joint session, 12 March; for text, see Public Papers of the Presidents of the United States: Harry S. Truman, January 1 to December 31, 1947 (Washington, DC: Government Printing Office, 1963), p. 176, or Department of State Bulletin, 23 March 1947, p. 534.

9 See Chapter 1 of the present volume.

10 Clinton Tyler Wood, Deputy to the Assistant Secretary of State for Economic Affairs.


12 Wilfred Malenbaum, chief, Division of International and Functional Intelligence.

13 William A. Salant, assistant chief, Division of German and Austrian Economic Affairs.

14 Philander P. Claxton, assistant to the Assistant Secretary of State for Occupied Areas.

15 Brig. Gen. Marshall S. Carter, special assistant to
Secretary Marshall.

16 Edward S.Mason, professor of economics at Harvard University, and a consultant to the Department of State.


18 Ernest Bevin, British Secretary of State for Foreign Affairs.
4 1951 European Economic Integration


The European Recovery Program was regarded from its inception as an opportunity to
produce more than simply economic recovery. It was widely agreed, abroad as in America,
that Europe had long lacked cohesion, and suffered from that lack. Political, cultural, and
economic forces in Europe were centrifugal rather than centripetal. This fact was held
responsible for many deep-seated European ills, including a propensity for starting wars.

Except for Eastern Europe under the leadership of the Soviet Union, the world regarded
the recovery program as an opportunity to usher in a new era of European collaboration,
cooperation, unification, or integration—to run the polysyllabic gamut. This new era, it
was held, was required for its own sake, for the sake of improving the standard of living of
Europe, and as a contribution to peace.

By 1950 none of the widespread sentiment in favor of European integration had abated.
The area involved was confined practically to Western Europe, because Eastern Europe
would not, or could not, participate. But the question of European integration was regarded as more pressing than ever. Western European integration—to confine ourselves to a single term—was sought as a means of enabling Europe, whose production had recovered remarkably, to achieve the elimination of its remaining balance-of-payments deficit on current account. Integration was further sought as a means of avoiding the necessity politically to rely on any one Continental power, at the risk of encouraging the enmity of others. Finally, it was felt that Western Europe would be strong enough to defend its area against possible attack from Eastern Europe only if it were unified into a single economic whole.

While the reasons supporting the economic integration of Europe were changing, at no time was there in existence a single clear idea of what it meant.

Some of the original authors and negotiators of the European Recovery Program on the United States side—notably Messrs W.L. Clayton and L.W. Douglas—appeared to believe that integration was that state of resource allocation achieved over a period of time by the complete removal of trade barriers. Under the impetus of this view, new urgency was given for a time to the Belgian-Netherlands-Luxemburg customs union, and to similar partial arrangements between France and Italy, on the one hand, and among the Scandinavian countries on the other. The Committee of European Economic Cooperation (CEEC) agreed
to study a customs union among all the countries of Western Europe, as a means of recovery. It was widely recognized, however, that the British government held aloof from this type of arrangement on the ground that its trade ties with, and obligations to, the members of the British Commonwealth prevented a relationship with the countries of the Continent as intimate as this. 1

Another early view was that the road to integration and recovery lay through collaborative planning, including especially the planning of new investment required for higher levels of overall output. The criteria on which this planning was to be based were not always set forth. One possibility was to plan in terms of the most efficient uses of existing resources without regard to balance-of-payments considerations in Europe. Another was to distribute new investment among the countries of Europe in ways which would best promote balance in European trade. The United States, for the most part, kept the first consideration in mind. Opposition was registered to small and inefficient steel plants or oil refineries spotted in each country of Europe engaged in drawing up long-run plans. In Europe, on the other hand, integration was regarded to a large extent as a division of labor designed to balance trade on agreed lines. Mr Bevin once suggested that France should permit Britain to concentrate on the manufacture of farm machinery while France, in turn,
specialized in the manufacture of farm tools.

Early in the development of the European Recovery Program, and particularly after the

brilliant report of the Economic Commission for Europe appeared, it was apparent that

Europe had become far more disintegrated than prewar in its internal trade. The revival of

trade after the war had begun slowly at best. Given the scarcity of reserves of gold and dol-
lars, despite sizable dollar assistance, the countries of Europe were reluctant to spend gold

and dollars in payment of net imports from one another. The availability of other acceptable

currencies to discharge net deficits, or of credit to finance them, was even more limited.

The result was that trade developed along bilateral lines. Attempt was made to limit sharply

imports of nonessential goods from other countries. At the same time, exports of luxury

products of domestic production were forced abroad to the maximum. The preponderance

of the former of these tendencies left stranded resources in a number of countries which

historically had produced for neighboring markets—Dutch truck gardens, Italian citrus

groves, French vineyards, etc. Their products were less vital to reconstruction than wheat,

steel, coal, and other products which required dollars. To find some basis on which these

resources could be used to advantage was regarded as a problem in widening European

bilateral to multilateral trade and integrating the European economy.
The present paper proposes to examine the possibilities of customs union, of planning, and of a clearing union on a European-wide basis, and to discuss their relevance to the problem of European recovery as it stands in early 1950.

The conclusion which emerges from this examination is that schemes focused solely on Europe have almost no connection with the basic issue in European recovery. (2) The Problem of European Recovery

In 1947 when the European Recovery Program was projected, the basic problem in the reconstruction of the European economy was to re-establish production. An attempt to restore equilibrium in the balance of payments by the redistribution of existing production in favor of exports, or by cutting down consumption and investment through restriction of imports would have involved the acceptance of a standard of living then and in the future which was politically unacceptable. In some cases, indeed, it would have been physically inadequate to sustain life and production.

By 1950, however, the problem was no longer one of production. Output as measured by the available indices was well above 1938 levels in most of the countries of Europe.

Abstracting from the intricacies of how much of this production was going to investment, from changes in the terms of trade, the increase in population, the relative portions of 1938 and 1950 production being wasted in military expenditures, the altered distribution of
income, the gross capital exports made by Europe, and a number of similar qualifications, it could be said, by and large, that the volume of production of goods and services was sufficient to support a politically acceptable standard of living for Europe as a whole, with a balanced international position. In fact, however, Europe still had a substantial overall deficit with the rest of the world, and a much larger deficit in dollars. Judged by the standard of restoring production, the European Recovery Program was an outstanding success. Measured against the objective of enabling Europe to balance its international trading position without quantitative restrictions on current transactions, a considerable distance remained to be covered.

The present paper is not intended to discuss the relative merits of planning and the self-regulating market in achieving either substantial increases in production or balance-of-payments equilibrium. Whether the road to ultimate recovery lies through more planning, through monetary and fiscal policy, exchange policy or ad hoc solutions to such problems as that of the sterling balances, is not here at issue. The question is rather whether the solutions adopted can appropriately be applied on a European-wide basis.

The problem is essentially one of resource allocation. Does planning result in the expansion of those industries whose goods turn out to be wanted, so that resources engaged in
them are, in fact, producing exports which can be sold on favorable terms abroad, or goods
for domestic consumption which can substitute for imports without vastly increased costs?
Will disinflation or exchange depreciation restrict consumption at home of goods which
can now be sold abroad without a drastic adjustment of the terms of trade, and cut off
foreign imports for which substitutes can be produced efficiently by domestic resources
in their present locations? Mistakes may be made under the response of free enterprise to
prices, as well as under planning. And mistakes may be as easily corrected, economically
speaking, under planning as by private enterprise, if resources are easily shifted from one
industry to another and if the scale of operations in the two cases is similar.
It is mainly when resources are badly located and relatively immobile that the trouble
enters. Planning or the response of privately directed resources to market stimuli may
have to overcome the inertia of traditional locations and lack of housing, social services,
transportation, etc., in growing industries in order to get labor to move. Capital, broadly
speaking, can be moved without loss only at a rate at which, as it is consumed in one
occupation, its counterpart in the depreciation allowances charged to the old product can be
accumulated for capital formation in a new. Land is almost entirely immobile.
When planning produces the wrong products, or price
reductions necessary to sell goods

reveal that resources are engaged in industries where they are earning a return less than

that available to them elsewhere, adjustment may take one of two forms. The loss can be

incorporated in the system and the resources left in place, with society undertaking through

subsidy to bring their return up to that which they might enjoy in other occupations. Or the

loss can be written off and the resources can be shifted once again. Unhappily in the real

world the nature of this choice is not understood, or if understood is met with indecision.

The result is that consumption is frequently maintained at too high a level, and no steps are

set in motion to shift resources into more productive lines so as to provide ultimate support

for the level of consumption in the future.

If decision be taken to readapt resources by taking losses and moving them, the short

term position is made worse. Society must meet the costs of transferring the resources, as

well as forego their product during the period of transfer. Labor may require the incentive

of increased wages to move from one labor pool to another, even though the shift be from

unemployment to employment, because of the overhead costs of moving of the individual.

In total, the task of moving resources from one occupation to another under such circum

stances may be considered as usually inflationary. It accordingly requires further planning

or a further market adjustment to carry it out.
The ultimate restoration of convertibility and multilateralism presupposes that the resources within the countries in the system will already be located in those occupations at which they can earn the highest return, given the amounts and deployment of natural resources, labor and capital, and the costs of transfer, including tariffs, for commodities moving between countries. Whether these locations be determined by planning or by the price mechanism, deviation from them will set in motion one type of disturbance in the system. 5 International equilibrium can be restored, when this deviation occurs, by adjusting to a lower standard of living, present and/or prospective; by accepting lower terms of trade and reducing consumption and/or investment in other directions for the benefit of the resources earning less than the going return; or by shifting the resources concerned into occupations where they will earn higher incomes, thus incurring the costs of moving the resources as well as an additional source of disequilibrium.

From this analysis the central problem of European recovery in the period 1950–2 emerges as follows: Must Europe reduce its consumption and investment to restore equilibrium in its international accounts; and, if so, in what directions; or must Europe undertake a further shift of resources from present to new occupations; and, if so, in what directions? It is against this statement of the problem that the separate or combined remedies put forward
European Customs Union

Advocates of European customs union urge three principal advantages for their scheme:

the superiority of the self-regulating market over planning; the law of decreasing costs made operational in a wider market; and the increase in mobility and competition of the broader market. 6 Each of these three reputed effects may be examined and judged against the requirements of the problem.

If two or more countries, trade among which is regulated by quantitative restrictions, payments regulations and tariffs, direct the use of their resources by rationing, allocations, and other controls, there is no reason why the removal of restrictions, regulations, and tariffs between the countries should enable them to convert suddenly to the direction of production and consumption through the forces of the market and the price system. By the same token, if each of the two or more countries involved desires to convert from direct controls to regulation by price and the free play of the market, they can do so without the necessity of abandoning trade restrictions between or among them. It may even be argued that the retention of external controls is useful while internal markets are being restored.

The last price to be adjusted may be the exchange rate, after free internal pricing has been restored to give depreciation or appreciation an opportunity to work fully. Abandonment of
direct controls on external transactions before freeing the
market forces at home is likely
to cause the country or countries with the largest amount
of repressed inflation to suffer
heavy losses of exchange.
Even if the case cannot be made that external controls are
needed to assist the elimina
tion of domestic ones, there is no necessary connection
between the removal of tariffs and
the freeing of the market mechanism. Professor Haberler
argues that the slogan of eco
nomic union in Europe, in fact, detracts attention from the
real need for freeing the market
of interferences and controls, internal and external. As
such, he regards the customs union
movement as harmful. 7
The notion that customs union makes possible the
achievement of economies of scale
and decreasing costs through enlarging the market is sound.
But it has little to do with
the recovery problem now faced by Europe. In the first
stage of European recovery, when
emphasis was on increasing productivity and raising the
ultimate standard of living which
European resources could expect to earn, large-scale
operation and especially efficient
operation made important sense. When the production problem
gave way to the problem
of how best to allocate resources, the overall
opportunities for decreasing costs can make
almost no contribution to it.
The matter may be put in terms of international trade
theory. A basis for balanced trade exists when relative prices differ in two countries. Assuming that production in both coun-
tries is sufficient to produce tolerable standards of living for the peoples of both countries, at terms of exchange between them that are within not too wide limits, the problem is
to distribute resources among various occupations in both in such a way as to produce balanced trade. An attempt to change relative prices to the point where the existing loca-
tion of resources will make possible balanced trade is likely to succeed only by the most remote coincidence. A change in relative prices will produce a new basis for trade which will require a different distribution of resources to achieve balanced trade. It can be de-
onstrated that this is a basis for trade on which it is possible for all countries to be better off. But if a tolerable basis for trade already exists, the shift to a new basis—even of better trade—without moving closer to the achievement of the resource pattern on which bal-
anced trade will be conducted, fails to advance the problem. It may be said, in fact, that the changes set in motion by customs union would be likely
to set back the achievement of international equilibrium. The gains from increasing returns to be achieved from the scrapping of inefficient watch, bicycle, silk, cosmetic, and similar capacity in Europe 8 and expanding efficient plants into still more efficient ones, must be weighed against the capital requirements which the program
entails and the availability of
new capital. The new capital requirements are likely, under present conditions, to represent

a new inflationary force which is additional to that
inflation necessary eventually to shift

resources into the occupations in which they can produce a balanced trade position with

maximum efficiency. Under these circumstances, there is much to be said for achieving

international equilibrium first and the benefits of decreasing costs second, at a time when

the inflationary effects of the new shifts of assets can be absorbed. But at this time it is pos

sible that a customs union will be deflationary. 9

There is something to be said for the view that customs union makes its contribution
to European recovery by rendering resources more mobile among occupations. If customs
union were accompanied by some elements of political and monetary union, as some think

inevitable, necessary or desirable, it might be that migration across national boundaries

would be rendered easier. Increased competition derived from the broadening of the market

in space makes demand curves more elastic for the single producer. This increased compe

tition at the same time may encourage easier entry and hence contribute to factor mobility

locally, as well as internationally.

There is, however, nothing inevitable about the connections, either between customs
union and increased competition or increased competition and easier entry. There is evi
idence to suggest that the elimination of tariff and quota restrictions is taken in Europe as

the occasion to devise other means for dividing the market among manufacturers, particu

larly the business agreement. 10 And, if customs union were to lead to increased competition

among producers, there is no assurance that it would decrease the size of the unit required
to enter the business, or add overall to the numbers involved. To the extent that it did, of
course, the economies resulting from decreasing costs would not be achieved.

Factor immobility would appear to be a function of many other factors than size of mar

ket. It exists in large measure in the United States, which is a customs union. In fact, the

reluctance of factors to leave the areas of comparative disadvantage in the United States—
farming and standardized manufacturers such as textiles, shoes, simple pottery, etc.—is to

be ascribed to factor immobility. The widening of the cultural unit (far more perhaps than

the economic) and the broadening of the market, may contribute to mobility at a given stan
dard of living. They can contribute very little to overcoming the immobilizing qualities of

tradition and continuity in older countries and poverty in relatively undeveloped areas.

Judged in these terms, the notion of customs union may be regarded as not only con

tributing little to European recovery but also as failing to meet the major point involved. 11

The nature of this irrelevancy, however, will become
clearer as “planned integration” and clearing union are examined. (4) Planned Integration

It is assumed for the purposes of this section that planning, on a European-wide basis at least, is not only possible but feasible with a small margin of error. It is not necessary to indicate whether this planning is the kind which involves national ownership of industry and international decisions as to investment in all countries, or merely the shaping of national decisions in the light of awareness of what is transpiring in other markets, and the suppressing through mutual agreement of investment which is clearly redundant, plus the encouragement of investment in areas which appear to be lagging. The question dealt with here is merely one of indicating the appropriate scale for planning.

If Europe were a closed economy, the notion of its planned integration would make sense. The resources of Europe could be weighed in the light of European wants, and the most effective use of these resources undertaken. The notion of integration in this context has almost an engineering character. While the economist must recognize that this may indicate some changes which are politically impractical, such as the shifting of surplus population to areas where capital and land are preponderant, the notion of European inte

gration has meaning. Even without factor movement, the maximum specialization and free trade in a self-contained system would leave residual
differences in standards of living but raise income overall. Integration in this sense would require the determination by planning of which resources were used in which industries.

Once the unit is broadened to include non-Europe, however, the question of the most effective use of resources within Europe becomes far less determinate. What degree of specialization is possible between Europe and the rest of the world? The best example is probably furnished by foodstuffs. It is impossible to decide the question of how to integrate European agriculture without, at the same time, deciding the extent to which Europe is to feed itself, and to what extent it can rely on imports of food from the rest of the world.

Even if factor mobility be assumed—and it be thought that the French, German, Swiss, and Belgian peasant could be either liquidated or made to operate at double the intensity of labor and capital in relation to land—the basis for organizing European agriculture must be sought in the wider integration of Europe with the rest of the world. Unless conceived as a closed economy, as explained above, one cannot plan for integration on a purely European basis. The only planning of Europe which makes sense is the plan which relates European production to European exports to and from overseas in the first instance, and European exports and imports within its own borders as a function of the production of the goods which Europe is to provide under the wider plan. (5)
European Clearing Union

The meaninglessness of European integration, apart from the concept of the integration of Europe into the world economy, is perhaps most clearly revealed in connection with the discussion which was going forward in early 1950 concerning plans for a European clearing union. The problem which Europe faced was complex and intricate at best. But the suggestion that it could be advanced by a European solution or a European clearing union did not reach the ultimate issue.

If each of the countries of Europe were to have balanced trade with all the others, and if each were to have an overall balance so that Europe would pay its own way, each would, of course, be required to have balanced trade with the outside world as a whole. But it should be evident upon reflection that this is a most unlikely result of multilateralism and convertibility. If it were reached by measures to this end, it would simply be a lesser degree of bilateralism than balance by each European country with every other. Yet on no less arbitrary basis is it possible to construct a European clearing union apart from clearing on a worldwide basis. 12

If the overall trade pattern with the rest of the world were settled, the task of arranging intra-European trade as part of European integration would be manageable. If it were clear in advance that the prewar pattern of trade could be established, and that Britain and the
Netherlands would earn sterling and dollars on balance which they would use to discharge gross deficits to the rest of the Continent, while Germany at the other extreme would have surpluses with all the countries in Europe from which it collected in sterling and dollars to requite its deficits with overseas areas, the allocation of net European deficits and surpluses among the countries of Europe could be undertaken. But the problem is essentially to evolve a pattern of European trade with non-Europe. And clearing devices which are limited only to Europe are obviously of little assistance in this. The point can be stated in mathematical terms by indicating that the solution for the upper left-hand corner of a large matrix cannot be reached independently of the solution to the rest of the matrix unless the smaller matrix within the large be assumed to be determined as a whole. To take a very concrete case at the other extreme, the question whether French resources engaged in hotelkeeping on the Riviera and in winegrowing in Garonne Gironde and Saône are most effectively employed from the point of view of European integration, turns on the question whether the United Kingdom will be able to run a deficit in France paid for with dollars and sterling. If not, these goods and services are likely to be redundant and the resources engaged in their production should be moved. But whether they should be moved into the production of wheat for
Britain or of manufactures for direct

sale to areas outside of Europe depends, in turn, on

whether Britain, supplied wheat by

France, can earn dollars and sterling to make available to

France, or whether the prospect

is for balanced trade in both directions.

On this showing, European clearing union by itself can make

little contribution to the

broader problem of resource allocation. The distribution of

European resources in such a

way as to contribute most effectively to the standard of

living of Europe as a whole can be

settled only after, or in connection with, the settlement

of the question of the distribution

of resources in Europe in such a way as most effectively to

balance trade between Europe

and the rest of the world. (6) Restoring Multilateral Trade

World-wide

It is easier to reach the view that the integration of

Europe must be envisaged in terms of

the integration of Europe into the world economy than it is
to suggest how the latter task

may be accomplished. Unless present social attitudes are
changed, it may not be possible

to reconstruct a multilateral world at all. Certainly the

results achieved thus far after World

War II are not encouraging.

The critics of Bretton Woods appear to have been right that

the Bank was too small for

postwar reconstruction purposes, and that its operations

are necessarily restricted in scope.

The Fund, too, was built on the assumption of equilibrium

everailing generally in relations
among currencies, so that its financing operations have been irrelevant to the major postwar problems which they were intended to meet. The key-currency approach, followed in the Anglo-American financial agreement, has not been a spectacular success. The Marshall Plan’s achievements in the field of production have been considerably weakened by its failure in the restoration of multilateral trade and convertibility. Cancellation or United States funding of the sterling balances owned by Britain’s creditors is unlikely to provide a complete solution. The resumption of foreign lending by the United States on an untied basis, or better perhaps with loans tied perversely to exports from countries outside the United States, is unlikely to be given a practical test as a means of meeting the requirements of the problem. The draft charter of the International Trade Organization (ITO) sets forth a standard of conduct which cannot become operational until equilibrium has been achieved.

Whether one favors planning or the restoration of the free pricing mechanism, the achievement of that disposition of resources throughout the world, or the adjustment of levels of consumption and investment to the existing disposition of resources, poses a problem of such complexity and magnitude as to make it easy to feel discouraged. Almost like juxtaposed cardboard soldiers, no one of which can remain upright unless they all stand,
system of multilateral trade requires that no inconvertible
deficit exists or goes unfunded.

If a gross deficit in a country is associated with a net
deficit in a given country, countries
earning gross surpluses in trade with that country will be unable to convert them into cur-
rencies needed to discharge their gross deficits. And the
countries with which they, in turn,
have gross deficits will be unable to convert their surpluses for the purposes of discharging
their gross obligations.

It may be argued that putting the problem in this light is to make the strongest possible
case for restoring the market mechanism and free pricing. Certainly the case of planned
integration on a world basis assumes a highly tentative character when one contemplates
the disposal of resources in a vast system of interlocking countries, and the lack both of
sufficient knowledge or institutions adequate to handle the problem of the allocation of
their resources. On the other hand, the market mechanism is no guarantee of success in
restoring convertibility; the devaluation of sterling against the dollar, for example, will
not restore multilateral trade until the Indian rupee is devalued against both the dollar and
sterling, and by the appropriate amount. Interference with the market mechanism, whether
through the fixing of exchange rates, or through government or business interference with
the dictates of the pricing system, is certain to be so pervasive (and in many cases so biased
in the self-interest of the forces interfering in the market) that it is impossible to rely upon
the establishment and maintenance of a worldwide market system.
There is a strong temptation on this account to argue that the multilateral system of the
nineteenth century was an accident, built of British economic hegemony, the London capital market where distressed debtors could raise funds, and the British commodity markets
where distressed goods could be sold, of the worldwide mobility of capital and labor and
of the rapid rate of economic growth which took place throughout the economic system.
On this showing, the attempt to restore an automatic or self-perpetuating multi-lateralism
could be a chimera; and each country would do well to order its resources so as to balance
trade with each country, or to reap the benefits of such limited triangular or multiangular
trade as could be contrived from time to time.
Such may be the admonition of the realist. And yet instinct seems to suggest that there
is room for a position between the idealistic attempt to re-establish a bygone multilateral
ism and the cynicism which would suggest that bilateralism is the inescapable road of the
future. This middle course is discrimination to enlarge trade. (7) Discrimination to Enlarge Trade
The most-favored-nation clause of the nineteenth century served a useful purpose, as trade
barriers were in course of erection, in limiting the growth of trade restriction. The tempta
tion to raise tariffs to all but a favored neighboring country was strong; the realization that this neighbor as well would be affected by the tariff assisted in the resisting of this temptation.

The application of the most-favored-nation clause in periods of tariff reduction, however, operates in the same fashion—to limit the extent of tariff change. The British and French objection to the Ouchy agreement of June 1932, between the Netherlands and Belgium, which undertook to reduce tariffs by 10 percent a year for five years, was based on the application of the letter of the most-favored-nation clause, but not its nineteenth century spirit.

The fact that custom and the ITO charter permit 100 percent customs union but nothing short of that degree of tariff discrimination, has been attacked recently and defended. Wilcox admits that the distinction is illogical. Henderson and Ellsworth see no sense in it. Wilcox, on the other hand, defends it as relative to the broad distinction between preferences which are limited and restricting and customs union which is fruitful. Brown sees subject to abuse. made, however, it must be granted that the case for free trade includes a positive case for valid. This would be the case if preference were one of the social institutions which is indis visible, and which like marriage, in theory at least (but
unlike friendship), is all or nothing;

trade. It is not clear how to establish the validity of these views or their inapplicability.

Yet there is a real possibility that in Europe it is necessary to be on guard not so much to operate to restrict intra-European trade more than trade in general. To reduce imports is a more certain method of correcting a deficit in one's own balance of payments than to expand exports. The former is under the control of a country, except within the broad political limit imposed by the standard of living and investment which the public (or its constituent groups) insists upon. There is a temptation, moreover, to cut down on imports from neighboring countries more than on those from far-off countries. The countries of Western Europe have much the same factor endowment. Their trade with one another consists already of exchanges based on economies of scale rather than trade among regions of different factor proportions. Trade with non-Europe consists in the exchange of goods embodying plentiful European factors for those produced mainly by factors which are scarce in Europe. Under these circumstances, it is easier in terms of ultimate factor mobility to contemplate cutting down imports from Europe as a means of balancing a country's overall trade position, than to cut down imports from other countries or to expand exports elsewhere.

While European integration by itself has no contribution to
make to the central problem

of European recovery, a strong case may be made against European disintegration; in favor

of integration and enlarged specialization within Europe; and for integrating Europe with

the rest of the world in ways which contribute the most to, or detract the least from, Euro

pean integration. Some of the resources stranded in Europe through the shift of multilateral

to bilateral trade will probably be forced to move in any event. The loss of British and

Dutch income from overseas may result in a decline in demand for French and Swiss lux

ury goods and services, which may not be offset by an increase in effective United States

demand. But some resources which are immobile will be wanted in the same occupations

after the structural disequilibrium in the European balance of payments has been corrected;

and these should be maintained where they are during the transition period to escape the

costs of shifting them out and back again.

The integration of Europe can be promoted in the process of correcting the disequilib

rium between Europe and the rest of the world by discriminatory reductions of trade bar

riers and quotas on products to be affected by new investment. While administratively it

may prove impossible to have tariffs and quotas apply to the product of existing resources,

which should not be disarranged faster than capital can be consumed where it is, there is

no reason to undertake new investment except on the basis
of the widest possible market

in Europe and abroad. Quotas in the field affected by new investment could be dispensed

with altogether. Tariffs should be lowered to the level of variable costs in the inefficient

locations, with perhaps additional subsidies for new investment to make allowance for the

time when the old capital will be fully consumed.

As for integration in the long run and for itself, quite apart from the context of Euro

pean recovery, there are doubtless wide opportunities for the elimination of small-scale

enterprise in Europe and the achievement of economies of large-scale output to increase

efficiency and real income. These opportunities must be measured against the capacity

for their achievement as represented by the supply of capital available and its opportunity

costs. A considerable number of inefficient industries in Europe, however, will probably

prove to be economic in the long run, because of the demand for individually styled and

produced products. The major opportunities for economies are likely to be found, not in

the rationalization of industries regarded as typically European, but in the development

of further efficiency in agriculture or a new disposition of resources which would make it

possible to liquidate the peasant as an economic institution. This is by no means a problem

of integration among European nations. What is called for is the development of efficient

practices and institutions of farming in Europe or a
greater degree of integration between
the individual countries of Western Europe and the rest of
the world. Notes

1 See R.G.Hautrey, Western European Union (Oxford: Royal
Institute of International Affairs, 1949), esp. p. 77.

2 Economic Commission for Europe, A Survey of the Economic
Situation and Prospects of Europe (Lake Success, NY:

3 On the whole, the writer is convinced that the truth
lies between the extreme claims of the planners and the
free-pricing proponents. In particular, it is likely that
more planning and attendant rationing, price control,
allocations, etc., are needed in the early stages of
recovery and more free pricing in the later. (This view, it
may be observed, does not involve advocacy of complete
disregard of the inflationary gap in the early states of
postwar recovery.) The success which is likely to attend
monetary, fiscal, and exchange measures in the later
stages of recovery, however, should not be used to justify
them in the earlier. But, of course, it will be.

4 Cf. the parallel expansions of private American
companies and government-directed British and Norwegian
enterprise in crude-oil production and refining, on the one
hand, and tanker construction on the other.

5 Another may originate from the monetary and fiscal side.

6 For a combination of all three, see Mr P.G.Hoffman’s
speech of 31 October 1949 (quoted in full in the New York
Times for 1 November 1949, p. 29) before the Council of
the Organization for European Economic Cooperation: The
substance of such integration would be the formation of a
single large market within which quantitative restrictions
on the movement of goods, monetary barriers to the flow of
payments and, eventually, all tariffs are permanently
swept away... The creation of a permanent, freely trading
area, comprising 270,000,000 consumers in Western Europe
would accelerate the development of large-scale, low-cost
production [and] would make the effective use of all
resources easier, the stifling of healthy competition more
difficult. Obviously such a step would not change the
physical structure of European industry, or vastly
increase productivity overnight, but the massive change
would, I am convinced, set in motion a rapid growth in
productivity. This would make it possible for Europe to
improve its competitive position in the world and thus more nearly satisfy the expectations and needs of its people.


8 See “Freeing of trade in Europe lagging,” New York Times, 27 November 1949, p. 34. Written from Switzerland, the dispatch emphasizes trade in watches as an area in which integration is needed, although it is far from clear that French restrictions on watch imports from Switzerland arise from protectionist sentiment so much as from an overvaluation of the franc vis-à-vis the Swiss franc, and a consequent disposition of the French people to spend inflated incomes, or excessive liquid reserves, on watches in excess of the capacity of the French economy to earn them on a current basis.

9 It may be argued that the capital for the new investment can be provided from the depreciation allowances on the scrapped inefficient plant as customs union is achieved by gradual reductions in tariff barriers. Protection would then be limited to the point where producers in the protected country could cover their variable costs plus depreciation, but no other overhead costs. The capital represented by depreciation allowances, however, is likely to be consumed or reinvested in the country of ownership, rather than in the same industry in another country, except under sweeping assumptions as to political and currency union and entrepreneurial mobility.

Again, the new plant is likely to be larger than the two old ones combined, if real economies of scale are possible in the long run, and to involve an increase in total capital requirements, except in the face of capital-saving technological advances.

Another problem is posed by the fact that depreciation allowances accrue gradually over time, whereas capital required by new plant construction or capital expansion is needed in a single investment.

It can be held that the effects of customs unions will be inflationary in periods of overall inflation, or full employment, and deflationary in periods of deflation. This is on balance and for the sum of the countries involved. The asymmetry is due, of course, to the fact that in periods of deflation, the old plant in what is to become the exporting country is unlikely to be working at full
capacity.


11 Almost equally irrelevant is the suggestion of customs union between Europe, or parts thereof, and the United States. See I.de Vegh, “Alternative to handouts,” in Fortune, November 1949. It should be mentioned that the disequilibrium in the balance of payments of a large part of the world coexists with the fact of production for export to the United States of items on the free list—a partial customs union.

12 The Economic Commission for Europe, however, has recommended that each country within Europe seek to balance its trade with all others in the area. See op. cit., pp. 113–14; and Economic Survey of Europe in 1948 (Washington, DC: US Government Printing Office, 1949. Printed for the use of the Committee on Foreign Affairs), pp. 114–16. This objective is advanced merely as more generally desirable than for each country to try to achieve a surplus in its trade with Europe.


Assume that countries A, B, C are in “Europe” and D and E the rest of the world in the matrices below. Case I represents the situation under prewar trade; Case II, the position in which overall inflation in “Europe” (or deflation outside it) has increased European imports and decreased European exports. Importing Country Exporting Country CASE I CASE II A B C D E Total Exports A B C D E Total Exports A – 5 5 2 2 14 – 5 5 1 1 12 B 2 – 5 5 1 1 14 2 – 2 4 4 12 C 2 5 – 5 2 14 2 5 – 4 1 12 D 5 2 2 – 5 14 6 3 3 – 5 17 E 5 2 5 2 – 14 6 3 6 2 – 17 Total Imports 14 14 14 14 14 14 70 14 16 16 11 11 70 Surplus or Deficit 0 0 0 0 0 0 0 0 0 4 4 4 6 6 0

It is evident from the case postulated:

(a) that trade in “Europe” will tend to be balanced bilaterally, in the absence of efforts to prevent it;
(b) that C will benefit from a “European” clearing union which is designed to produce balanced trade in Europe; but

(c) that balanced trade in “Europe” is an adequate solution neither for A nor B; and

(d) that “European” clearing union as a slogan by itself may possibly even be actually harmful in that it distracts attention from the main problem.


The theoretical analysis given by the last three chapters [International Economics, 1953] has been interlarded with a trickle of examples. It may be useful to the student, however, if we vary the heavy dose of theory with an entire chapter devoted to illustration of the various types of disequilibria before returning to summarize remedies. One example will do.

The problem of European recovery after World War II combines aspects of cyclical, secular, and structural disequilibrium at the goods and factor levels. In a single chapter we shall be unable to sort out all elements, much less cover the factual and institutional aspects of the problem; but we can vary the diet of theory and perhaps furnish the student an insight into the unyielding character of these problems in the real world. Balance of Payments

Europe’s balance of payments showed a deficit on current account of $5.8 billion in 1946 and $7.5 billion in 1947, as compared with approximate balance in 1938. The changes are given in broad detail in Table 5.1. (In this chapter “Europe” sometimes means all of Europe, excluding the Soviet Union, and sometimes only Western Europe, including Greece, Turkey, and Iceland, which par
ticipated in the European Recovery Program (ERP). For most purposes, the distinction is
unimportant statistically. Where it may make a difference, pains will be taken to be explicit.

The entire discussion of ERP will, of course, run in terms of “Western Europe.” And Table
5.1 relates to Europe as a whole except the Soviet Union.)

Table 5.1 Europe’s Balance of Payments
(In billions of dollars at current prices) 1938 1946 1947
Merchandise imports (f.o.b.) +5.5 +9.4 +13.0
Merchandise exports (f.o.b.) +3.7 +4.3 +6.1
Net merchandise trade −1.8 −5.1 −6.9
Income from investments +1.2 +0.5 +0.4
Transport and other invisibles +0.6 −1.2 −1.0
Net invisible trade +1.8 −0.7 −0.6
Balance on current account 0 −5.8 −7.5

The reasons for this deficit can be given at various levels of analysis. In elementary
terms, Europe was able to run a deficit of $7.5 billion because it was able to finance it. If it
had not obtained gold and dollars in 1947, both from its own prewar holdings and through
assistance from the United States, Canada, and other Dominions and newly created inter
national institutions, the International Monetary Fund and the Bank, it would have had to
balance imports and exports. If there is no way to pay for imports other than by exports,
exports and imports must balance. But if we shift to a more fundamental level, the causes
of the European disequilibrium may be seen to be many,
varied, and complex. Causes of the Disequilibrium

At least eight reasons contributed to the disequilibrium. Five of these were internal to Europe, and three concerned the relations between Europe and the rest of the world. The internal changes were as follows:

(1) Loss of domestic capital through war damage and capital consumption

(2) Growth of population

(3) Redistribution of income within countries

(4) Monetary chaos inherited from war finance

(5) Loss, in occupied countries, of political cohesion and discipline

Added to these were the changes in Europe’s relations to overseas areas:

(6) Decline of overseas assets, including ships, and rise of liabilities

(7) Change in the terms of trade between Europe and the rest of the world

(8) Growing assertion of economic and political independence from Europe by previously dependent areas

Each of these reasons could be developed into a long chapter. In the compass of this book [International Economics, 1953], however, they can receive only one or two paragraphs apiece. (1) Capital Losses and Capital Consumption

Losses through war damage were important, especially in Germany and in Eastern Europe.

But far more capital loss was visited on Europe through capital consumption, i.e., through depreciation of capital which was not made good. In Britain, for example, in six years of
war, household goods of only four normal years were produced. In some areas, net capital was built up during the war. This was the overall case in the United States. British farms ended the war with 190,000 tractors compared with 60,000 in 1939. But, in Europe as a whole, perhaps 15 to 20 percent of the capital in existence in 1939 had worn out or been destroyed by the end of 1945. These losses were not spread evenly throughout the economy. A shift to different factor proportions, involving less capital per unit of labor and land, would not therefore have been feasible. Working capital in inventories of raw materials was reduced much more than were buildings and equipment; and no amount of the latter could substitute for the former. Where a single critical machine was missing from a factory, the productivity of the whole plant might be reduced sharply, rather than by the percentage represented by the value of the machine divided by that of total equipment. The specialized character of capital requirements, in the early stages of recovery at least, meant that increments of capital investment gave large and increasing returns. This constituted an argument against trying to reduce income to the level of existing production. Positively, it constituted an argument for borrowing. (2) Increase in Population Total population in Europe fell during the war, but by hardly as much as one might have expected from reading the Sunday supplements in the 1930s dealing with “total war.” Europe, excluding Turkey, declined from 392 to 383 million.
But these declines were not evenly spread. Eastern Europe suffered heavy losses due to war casualties, concentration camp murders, and emigration. In Poland the decline amounted to 10.9 million, or a third of the total population. In Western Europe, however, the population rose from 250 million on the average from 1934 to 1938 to practically 270 million in 1947. Part of this was due to the immigration from Eastern Europe; a considerable part represented an increase in the birth rate. Demographers who study population changes are baffled by the inconsistency of people who talk as if war made the world unfit for children, but react to it by having more. These increases more than offset the considerable numbers killed by hostilities. An increase in population by itself need cause disequilibrium only at the factor level as labor increases relative to land; and this could be mitigated if capital grew concomitantly with labor. But the postwar position in Europe was more serious because of the skewed distribution of population. The refugees—largely old people, women, and children—and the natural increase in population—all children—added much more to the consumption side of the equation than they did to production. The labor force may have increased by a small percentage, but within it the number of able-bodied men declined and that of women and handicapped men rose. The increase in population thus meant a decline in, or at least a change in the composition of, output and an increase in demand. The effect was to superim
pose a serious structural disturbance at the goods level on a factor disequilibrium. (3) Change in Income Distribution

In Scandinavia, the Netherlands, and Britain, wartime governments had been concerned with “fair shares,” and labor governments continued this emphasis into the postwar period.

High rates of progressive taxation cut into savings; food, health, and other subsidies increased consumption. The redistribution of income increased spending, changed the level of income, altered the propensity to import, and required a new equilibrium allocation of resources to exports and investment. Government, however, was not content to allow investment to decline with the fall in personal savings. In particular occupations, such as coal mining, a change took place all over the world.

Coal miners, who had been among the lowest-paid class of workers, insisted upon higher wages. With full employment, wartime miners left the pits, and demobilized miners failed to return until their rates of pay had increased to the highest of all semiskilled fields. This was true in the United States as well as in Britain, France, Germany, and Belgium. This sort of change by itself will produce a disequilibrium in the balance of payments of coal-using countries. In the case of Western Europe, which needed coal and steel for recovery, it was therefore necessary in the period of adjustment to buy coal from the United States at rates approaching 40 million tons a year. The coal cost approximately $5.00 at the mine in West
Virginia, $9.00 at Hampton Roads, where it was loaded on ocean-going ships, and more

than $20.00 a ton delivered. This failure in production, combined with large needs, required

the expenditure in one or two postwar periods of approximately $800 million a year. (4) Monetary Chaos
Inherited from War Finance

Because of this inflationary war finance, the volume of money—both currency and bank

deposits—increased many fold in most countries of Europe. Credit creation took place, as
government bonds were sold to banks, but price controls and rationing prevented the funds

from being used up. Many households and corporations began the postwar period with

large supplies of cash which they regarded as available for spending to meet the backlog of

unsatisfied demand and deferred depreciation. If households and corporations are going to spend more than their current income, infla

tion can be prevented only by government spending less than it receives in taxes, by an

equal amount. This was difficult to achieve, because governments, too, had large backlogs

of deferred projects on which expenditure was urgently required. In the absence of mon

etary reform, inflation was almost inevitable until the accumulated deficits of corporations

and households reduced the volume of money to normal requirements. The immediate postwar inflation in the United States was of this same sort. In the inter

war years, it was believed normal for government accounts to be balanced, for corporations

and households to save a considerable amount out of their current income, and for corpora
tions to borrow these sums and invest them. Wartime, however, is a period in which income theory has perhaps less relevance than the quantity theory of money. The quantity of money created during the war was a strongly inflationary force postwar. In liberated and defeated countries, monetary reform and a new start were possible. The money generated by the German war machine could readily be repudiated. In a country like Britain, which had not been occupied, however, the promises made to the people during the war had to be honored. A comparable problem in the international sphere was presented by the accumulation of sterling balances by British colonies, Dominions, and allies during the war, which, it was felt, could not be repudiated. This is discussed under paragraph 6 below.

(5) The Loss of Political Discipline

When the Wehrmacht occupied the country, it was patriotic to evade regulations, soldier on the job, patronize and sell in the black market, consume rather than save. All the economic drives needed for reconstruction had been inverted. Governments in exile, particularly, had difficulty in obtaining the unquestioning cooperation of people who had suffered through the occupation. (6) Net Loss of Overseas Assets

The swing in the balance of indebtedness of Europe vis-à-vis overseas countries was particularly acute in Britain and the Netherlands. These countries had typically earned a large portion of their current income and percent of current credits in the balance of payments, respectively, from overseas assets of various
kinds—government and private bonds, direct

investments in insurance companies, plantations, mines and factories, and even marketable

shares floated in New York. British overseas assets declined by £1.1 billion from September 1939 to June 1945. In addition, because of the very favorable arrangements on war finance made with the dependent portions of the Commonwealth, sterling balances had been built up by £2.9 billion.

A loss of gold and dollar reserves of £152 million brought the total swing in the balance of indebtedness to £4.1 billion or, at $4.03 to the pound sterling, $16 billion. This sum, to be sure, would have been far larger had it not been for Lend-Lease and assistance from the Dominions. But any exports which went to reduce the depleted foreign investments would be “unrequited” in the sense that the United Kingdom failed to get from them the exchange with which it could pay for current imports. The Western European fleet of ships declined from 48.2 million deadweight tons in 1939 to 26 million by 1945. Recovery had taken it back to 39.6 million by mid-1947. The bulk of these losses through sinkings and attrition had occurred in the British and Norwegian fleets, and the German fleet had been eliminated by war losses and reparation deliveries of the remaining ships. The tonnage needs of Western Europe increased because of bulky imports of wheat and coal. More tonnage of ships cleared United States ports for Europe in 1947 than in any previous year in history, including the peak of
shipments during the war. The loss of overseas investments gives rise to structural disequilibrium not at the factor, but at the goods, level. Foreign capital was not combined with either domestic factors or production—except to an inconsequential degree in direct investments. Primarily it produced a stream of income. The decline of net investment income from $1.2 billion to $0.5 billion meant that Europe had to produce $700 million more of goods salable overseas or capable of replacing overseas products, to enjoy the same standard of living and investment, or had to reduce consumption and investment by $700 million below prewar levels, or some combination of the two. (7) Deterioration in Terms of Trade

There has been some dispute about the adverse change in Europe’s terms of trade. The Committee of European Economic Cooperation (CEEC) asserted that the world prices of the goods that Western Europe buys had increased over the war by 20 percent more than the prices of European exports. On this showing, the net barter terms of trade had declined from 100 to 83. A 17 percent decrease in the net terms of trade may mean either that the area could buy 17 percent less imports for the same exports or had to export almost 20 percent more exports to get the same value of imports. The Economic Commission for Europe disputed these data. Its indices showed that export prices had gone up practically as much as imports. It went on to point out, however, that, if a country or area starts out with a merchandise
trade deficit, doubling the prices of both exports and imports will double the value of the deficit. This, they thought, was partly Europe’s trouble. But here we must look into the question of the current account as a whole rather than the merchandise trade alone. If in period A the merchandise import deficit was covered by export of services of 20, the question arises in period B, what has happened to these? If the price of these services has doubled, too, the increase in price of the merchan
dise trade deficit is of no importance. If the services are sold at the old prices or if they are no longer rendered, then the doubling of the value of the deficit has significance. Period A Period B Exports 100 200 Imports 120 240 Deficit 20 40 Despite this dispute, there is little doubt that the world terms of trade during the war had shifted sharply in favor of primary products and against manufactures, or against the products in which Western Europe had a comparative advantage. In the world as a whole, total agricultural production had declined by 5 percent during the war, while the world’s population had increased by 9 percent. Any shift in terms of trade by itself is a cause of structural disequilibrium. The relative decline in export and rise in import prices is a signal for a shift of resources out of exports and into import-competing industries due to changes in world demand and supply. European recovery plans, however, took little note of this signal to redirect resources and invested new capital in the old manufacturing and heavy
industry lines. There is something to be said for the position that Europe was not entitled to terms of trade as favorable as those which had prevailed in the 1930s, when the prices of primary products were in continuous depression but manufactured prices held up. On this view, Europe’s decline in productivity relative to other parts of the world would have revealed a secular disequilibrium prior to World War II, had it not been for the fortuitous assistance of overseas depression. (8) Increased Independence of Overseas Areas

A new spirit of economic independence is reflected in the winning of political sovereignty by India, Pakistan, Indonesia, Israel, Syria, and Lebanon; and it is intimately bound up in the question of terms of trade and loss of overseas assets. In part, the younger countries are more alive to their opportunities to take advantage of the terms of trade, e.g., Perón’s raising of prices of meat, hides, linseed oil, and other exports to prices which proved untenable in the long run. In part, they nationalized European-owned property, as in Iran. Beyond these manifestations, however, there occurred a redistribution of income in favor of young countries which has sprung from their unwillingness to continue to accept without challenge the contractual decisions of developed countries, including particularly Western Europe. Higher wage rates, higher local taxes, lower profits—all emerge from this loss of world leadership. The result is a loss of income for Europe, which must be replaced—or
done without. The Origins of the European Recovery Program

The extent of the changes in the structural position of Europe was misjudged. In part, it had been hidden from view by the depression of the second half of the interwar period. In part, it had simply been misjudged, along with the failure to forecast the length and extent of the war. The result was that the wartime program for correction of the structural disequilibrium—UNRRA, or the United Nations Relief and Rehabilitation Administration—and the reconstruction side of the International Bank for Reconstruction and Development (IBRD) proved sharply inadequate. The wartime program had been supplemented before it got under way. This was partly necessary because of the abrupt termination of Lend-Lease after V-J Day, which President Truman has acknowledged to have been a mistake. But even with the enlargement of the lending power of the Export-Import Bank by $3 billion, the provision of military relief to liberated and defeated areas, the disposal of surplus property and surplus ships at reduced prices and on generous credit terms, the structural disequilibrium seemed too large. The Anglo-American Financial Agreement, providing $3,750 million of assistance to Britain, on condition that she make the pound sterling convertible within a year, failed for a number of reasons but mainly because the extent of the disequilibrium had been misjudged. The immediate relief job was concluded before much rehabilitation—especially of working
stocks of raw materials—had been accomplished; but UNRRA was abandoned and a terminal post-UNRRA program substituted. A major factor in these decisions was the difficulty or impossibility of agreeing with the Soviet Union on a vast number of questions. Luck had a part in the difficulties faced by Europe in 1947, as it has with many economic problems. A hard winter interrupted British production of coal, steel, and manufactured products. Early spring floods followed by frost destroyed French wheat seed in the ground and ruined the crop. Later in the summer a drought reduced agricultural output still further. Production was set back, and hopes still further reduced because of these failures.

The gold and dollars of a number of countries—France, the Netherlands, Austria—were running out. Recourse was had to the International Bank, and to the International Monetary Fund, whose funds were not supposed to be used for emergency purposes. At this juncture, Secretary of State Marshall suggested that, if Europe could plan a new approach to economic recovery, the United States would help. Emphasis in his speech was laid on the cooperative nature of the program. Before we deal with this aspect, we must address two questions which apply to the structural disequilibrium of a single country, as well as of a continent. The first is a question for the recovering country: What should its goals be and how should they be approached? The second is an interlocking question for others: How much help should be given to such an effort,
and on what economic criteria?

After dealing with these we shall return to the question of economic cooperation. The Goals of Recovery

The goal of recovery must be the highest standard of living, present and prospective, which is consonant with international balance on a recurring basis. This balance, of course, need not be a simple equality between exports and imports of goods and services. If the countries involved want to resume foreign lending, they must achieve an export surplus. To the extent that they will be able to borrow on a sustained basis, they can plan to complete the recovery program with an import surplus. The standard of living for which recovery should aim cannot be determined objectively by any known theorem of economics. To the economist, any standard of living is a possible basis of equilibrium; and, on the usual assumption that consumers are interested in maximizing their utility or welfare, no standard of living is high enough. The goal of recovery then must be, so far as the standard of living is concerned, a vague admixture of the historical, the desirable, and the feasible. The historical, in the case of the European Recovery Program, was the prewar level.

Here the most usual base was 1938, before the armament race had reached its most intense pitch. But observe that recovery to the level of 1938 per capita meant production at a higher absolute level because of the increases in population; that, in Germany, 1938 was a year of large-scale armament; that France was in depression in the
same year; that consumption standards were low in southern Italy in the prewar period, so that any decent standard would have to include more varied food. If the historical level was not always desirable, neither was it in all cases feasible. The prewar standard of living in Austria was hardly desirable, since it led to the growth of Fascism and Nazism; but until Austria became unified, with its sovereignty restored over the eastern territories occupied by the Soviet Union, it was hardly possible. The obdurate character of the Italian problem meant that little could be done rapidly with it. The average German standard of living was likely to remain well below the 1936 level for several decades, owing to the loss of capital and the growth of the numbers of consumers. In some countries the prospect for improvement in the standard of living was as important as the level achieved. This meant that an increase was needed not only in consumption but also in investment. The prewar stock of capital was regarded as inadequate, even on a per capita basis. The investment requirement for achieving the prewar level had added to it a further significant volume of investment for capital expansion. In some cases, particularly Britain, the recovery program was taken as an opportunity for correcting obsolescence—in mining, railroads, steel-making, and other basic industries. This added a third requirement for investment. Harrod has criticized the British recovery effort for being too ambitious in its investment undertakings; some projects, like the con
struction of a railroad tunnel through a mountain to save energy expended by locomotives,

were based on the recovery of the invested funds only over fifty years, or on the basis of 2 percent amortization. Capital must be cheap before projects of this low marginal efficiency can be justified. The standard of living and the level of investment appropriate to a recovery level are determined primarily by political forces. This is where the historical base is so important,

in combination with the asymmetry between increases and decreases in standards of living.

A country with a per capita income of $100 a year prewar and $100 a year postwar is likely to be better able to support this standard politically than another country which has suffered a reduction from $600 to $500. Much again will depend upon the distribution of income within the country and its political acceptability. A rich country in which there is sharp political disagreement about the distribution of income is in worse condition than a much poorer one in which the populace is agreeable or resigned to the distribution of income. A great deal of France’s trouble has been due not to the average level of the standard of living but to the fact that peasants, industrialists, rentiers, petite bourgeoisie (shopkeepers, clerks, etc.) and workers are fundamentally divided on the question of sharing; and all but the rentiers and clerks can do something about it. Industrialists raise prices, peasants divert food to the black market, workers go on strike for higher wages. In other countries—Germany, Italy, Greece—there
may be equal unhappiness about the sharing of the national income but less power in the peasants, workers, and petite bourgeoisie to affect the decisions of industrialists and rentiers who dominate government. Equilibrium might have been possible of achievement by adjusting the standard of living and the rate of capital formation to the level of production possible with existing capital assets after the war. This would have meant a standard of living well below the historic prewar level. Accordingly, the countries of Europe were constrained to set goals of recovery well above current rates of output. The Means to Recovery To correct a structural deficit in the balance of payments by increasing output rather than reducing expenditure means that something must get worse before it gets better. This may be the current standard of living: the necessary capital formation may be sought through austerity. It may be the deficit in the balance of payments: capital formation may be sought from abroad, or inflation resulting from attempting capital formation without successfully achieving austerity may spill over into increased imports. It may be possible to finance the increased imports out of existing foreign capital: this was the Belgian prescription after the war, much like killing the cat by stuffing it with cream. The Belgians permitted imports freely to fill up the gap in working capital and in household inventories. They were able to do so in part because their foreign assets—gold, dollars, and securities—had been built up
rather than depleted by the war. In the usual case, an attempt will be made to increase private capital formation and government expenditure through austerity and borrowing. This is illustrated in the comparison between 1938 and 1947 in Table 5.2 which gives a breakdown of gross national product in the United Kingdom. This table also illustrates the effect of disinflation-reduced spending and increased taxes—on the balance-of-payments deficit, revealed in the contrast between 1947 and 1948.

Table 5.2 The Use of National Product in the United Kingdom
(In percent) 1938 1947 1948

Current expenditure:
Personal consumption 72 65 62
Government 15 21 18

Total investment:
Gross capital formation-home 14 21 22
External investment -1 -7 -2

Gross national product 100 100 100

The alternative means to recovery were planning, priorities, rationing, price control, labor allocation, export set-asides, import quotas, etc., on the one hand, and budget balancing, credit restriction, and high interest rates, on the other. The decision as to which course to follow stemmed from the basic political philosophy of each country, and the extent to which various groups in the society were willing and able to follow the prescribed rules.
of conduct. In a highly individualistic society, or in one which is centrifugal in its group

pulls, rationing will not work for long. People and classes will not abide by it. It is therefore

necessary to use the price system more intensively. This means monetary reform; budget

balancing or budget surpluses to mop up excess cash; limits on borrowing to prevent excess

expenditure through credit creation. Social and political problems must be faced in deciding which groups are to be taxed to balance the budget and which groups are to be allowed

credit for capital formation or consumption. Even in those societies which rely heavily on planning and controls, however, the income

flow could not be entirely neglected. Excess purchasing power diverted some resources

from the tasks set for them by the priorities or by the labor allocation. In Britain, the “spivs”

and “drones” represented labor, if no other significant group of resources, diverted into

bookmaking, dog races, and other outlets for excess purchasing power. The Cripps austerity

budget of 1947, which ushered in the policy of disinflation, took pressure off the rationing

and price controls and made them more effective. It has been argued that the economy of repressed inflation is an empty economy, because

stocks are hoarded and people hesitate to sell scarce goods against redundant money. This

was found true in Germany before monetary reform, but not true in Britain after the policy

of disinflation. It has also been argued that suppressed inflation must end in open inflation.
This is not supported by European experience. However much the society is capable of relying on a planned system, it would be better to use at least some of its political unity to restrict credit and raise taxes for purposes of disinflation. It is necessary, too, to eliminate some expenditures, in order to fit total outlays to output without inflation. Counterpart Funds

One device for which much was hoped in limiting inflation was that of “counterpart” funds. Imports financed by the United States for countries participating in the European Recovery Program were not given to the ultimate consumers. They were sold by government in the par ticipating countries. The money received from this sale was the “local-currency counterpart” of the aid which took the form of goods. The first temptation of the receiving government was to regard these funds as income and spend them currently. In this way the deflationary effect of the import surplus would be offset by inflationary expenditure by the government. The first temptation on the part of the Congress of the United States was to regard this money as belonging to the United States government. This would mean that the United States had not granted aid to the participating country, but had merely sold it commodities for local currency. In the end, Congress insisted that 5 percent of the counterpart funds be retained for expenses of the Economic Cooperation Administration (ECA), which operated the United States side of the program and maintained missions in each participating coun
try, and for the purchase of raw materials where this could be arranged. The Economic Cooperation Act of 1948, enacting the European Recovery Program into law, provided that 95 percent of counterpart funds should be owned by the participating country but could be used only with the consent of ECA. However, ECA could not direct how the participating country should use them, but it could withhold its approval if the country proposed to use them in an inflationary manner. In actuality, counterpart funds have not proved to be as effective a device for shaping the fiscal policies of the participating countries as had been hoped. In an economically sophisticated country like the United Kingdom, the technique was not needed: the British have consistently allowed these funds to pile up for months at a time but have offset the sterilizing effects of the immobilization of bank reserves by open-market operations to maintain an appropriate level of reserves. Control of counterpart funds by itself is insufficient to direct monetary and fiscal policies when many other techniques are available for changing the supply of money or the flow of expenditure. At the other extreme, the Greek government has needed far more fiscal direction than counterpart funds in themselves provide. Quotas versus Depreciation Parallel to the difference of views between those who would plan and those who would use monetary and fiscal policy to create the conditions under which the price system could function in the domestic sphere is the difference between those who advocate import
restrictions and export set-asides in foreign trade and those who recommend exchange
depreciation. Increased production which closes the deficit must be exchange-earning or
exchange-saving. The question resolves itself into what mechanism is to be used to choose
new exports or replacements for imports. Under a system of planning, direct controls will
be used to keep out imports, to set aside goods for export, and, with priorities and alloca
tions of men and materials, to indicate new goods to be manufactured for export. Under
the price system the exchange rate will be depreciated to indicate, by raising the prices of
foreign-trade goods, which new exports and which substitutes for imports should be pro
duced. But this method will work satisfactorily only if the elasticities of demand are high
enough. One solution cannot be permitted. In the autumn of 1947, the CEEC stated that Europe’s
task was to produce goods and that the task of the rest of the world was to get them sold.
If this meant that Europe could produce any goods that occurred to it, based on histori
cal, sentimental, or other reasons, it would not serve. A structural disequilibrium must be
corrected by the production of goods in which the country or area with the disequilibrium
has the greatest comparative advantage or the least comparative disadvantage. It cannot
produce textiles simply because it historically produced textiles and then expect the rest of
the world to liquidate an appropriate segment of its
textile industry. If, on the other hand, the CEEC meant merely that the rest of the world would have to restrain itself from erecting barriers to the import of the goods produced by Europe in line with comparative advantage, the statement expressed an entirely legitimate view. Not only must the supply be elastic in the country with the disequilibrium; the supply abroad must be elastic in the face of decreases in price, which is simply another way of saying that demand must be elastic for the exports of the country taking action. The Scale of Foreign Aid

The height of the standard of living sought in a program of recovery from serious structural disequilibrium depends upon how large an import surplus can be run for how long, assuming that the resources thus obtained are going to be used with maximum efficiency. What, then, does the volume of foreign aid depend on? Clearly, on the height of the standard of living sought as a goal. There is mutual interdependence between foreign aid and the level of recovery. But in the European Recovery Program, the amount of aid was calculated in the first place from estimated balance-of-payments deficits. This was, to a considerable extent, reasoning in a circle. One place to have begun would have been with foreign aid. The United States might have said that there was to be available so much total aid for Europe. This figure might be the maximum available after taking into consideration other demands on United States resources; or it might have been simply an arbitrary figure to which other United States
spending by households, corporations, and government would be adjusted. Whatever its origin, the amount would then have been divided among the participating countries accord-

ing to some arbitrary formula. Each country would then be in position to see how much of an import surplus it could run. With an estimate of total production and the import surplus,
it could calculate what it had available for consumption and investment. The other way would be to start with total consumption and investment, deduct home production, and arrive at a figure for foreign aid needed. The latter was the original method followed by CEEC. Before the final report of the com-

mittee had been published, the group was contemplating, according to newspaper reports,
a balance-of-payments deficit amounting to $30 billion for four years. This was more than the United States could contemplate equably. The committee then reduced its estimate of the deficit for the initial year to $8.3 billion and to $19.6 billion for four years. The same circularity between the size of the program and the size of the deficit occurs in the Mutual Security Assistance Program, which took effect in 1951. Does the arma-

ment program determine the size of the aid; or does the aid available determine the size of the armament program? Here all countries, Europe and the United States, were readier to acknowledge the interdependence. In the European Recovery Program, however, the United States suggested that the balance-of-payments deficits experienced by European countries were independently determined and that United
States assistance was compensatory, to use the International Monetary Fund term for certain governmental capital movements. Professor Machlup has pointed out, however, that United States aid can equally well be regarded as the autonomous factor. One difficulty in gearing aid to deficits is that the worse the performance of the recovering country, the more assistance it receives, whereas the more quickly a country cuts its consumption and investment to get rid of its deficit, the less aid it obtains. In this system of dividing aid, inflation is rewarded and deflation penalized. This distortion of incentive became particularly apparent in the division of aid. The United States was concerned to limit its responsibility for the allocation of aid among the seventeen participating countries and required the Organization for European Economic Cooperation (OEEC), after the first year, to recommend a division. This was done in the second year with great difficulty. In the third year, the OEEC adopted a different view. It suggested that ECA divide the aid available in the same proportions as agreed upon the year before. Aid was no longer adjusted to balance-of-payments deficits derived from the difference between consumption and investment, on the one hand, and production, on the other. The country was told how much aid it would get, which it could use as it chose. To the extent that the disequilibrium was structural at the factor level, it might be possible to say that the level of aid was determined by the requirements of recovery. This
involves the readjustment of factor endowments to factor prices. On this showing, so much
capital formation is required, and, to the extent that it
cannot be provided at home, foreign
assistance is needed to make it up. But the joker in this
view is the fact that the capital
can come from domestic savings as well as from abroad,
provided that austerity can be
supported. The amount of aid needed is therefore determined
by the implicit levels of con
sumption and investment of the program and, in part,
determines them. European Cooperation

The United States requirement that Europe cooperate in
preparing and carrying through
its recovery program had an instantaneous appeal both to
Americans and to Europeans. It
was felt that each of the countries of Europe had been
trying to go its own way and that
frequently this had resulted in one country’s gain at the
expense of the others. In a sense
this was true. Most of the countries of Europe, and
foremost among them the United
States-United Kingdom zones of occupation in Germany, had
been trying to sell for dol
ars within Europe, while not spending dollars there, so as
to maximize dollars available
for expenditure in North America. The consequence, as we
said in Chapter 13 [of Interna
tional Economics, 1953], was that each country in turn
reduced its imports, and the trade
of the area progressively declined, particularly in those
goods which could not claim to
be necessities. The first solution offered for this problem
was admittedly temporary. This consisted of
“off-shore purchases” by the United States. If Italian
lemons could not be sold in Germany
or Dutch spinach, ECA would buy the commodities and ship
them to Germany. Germany
would get the fresh fruit and vegetables; Italy and the
Netherlands would get dollars. This
system was satisfactory enough as a stopgap. But it was
administratively awkward, since
it required ECA to find appropriate transactions and then
induce governments to carry
them out. An improved system was devised and later
regularized into the Intra-European Pay
ments Scheme (IEPS), which called for conditional aid. The
essence of the scheme can be
illustrated with a simple example. Suppose there are two
countries to be assisted—France
and the United Kingdom; that each has a deficit of $100 a
year with the United States; but
that France has an additional deficit of $50 with the
United Kingdom. This position can be
set forth as follows:

<table>
<thead>
<tr>
<th>Hypothetical Balances of Payments</th>
</tr>
</thead>
<tbody>
<tr>
<td>France</td>
</tr>
<tr>
<td>United States</td>
</tr>
<tr>
<td>Total Europe</td>
</tr>
<tr>
<td>Deficit with United States</td>
</tr>
<tr>
<td>Balance within Europe</td>
</tr>
<tr>
<td>Total balance of payments on</td>
</tr>
</tbody>
</table>

The system of conditional aid
can work in either of two ways, depending upon whether
the United States undertakes to finance European deficits
with itself or total deficits. If
it finances deficits with the United States, $100 each is
made available to France and the
United Kingdom, but the aid granted to the United Kingdom is given on the condition that it finance the French deficit in Europe. This could be done by Britain’s giving France the right to draw sterling to be spent in the United Kingdom. If the United States, on the other hand, financed total deficits, $150 would be granted in aid to France and $50 to the United Kingdom. Aid to France would then be made conditional on the French spending $50 in Britain so that the United Kingdom could get the other $50 it needed to meet its dollar deficit. Each system is objectionable to one party. Under the first, the French who receive $100 from the United States but have an overall deficit of $150 become dependent upon the British making available $50 worth of goods of the proper sort at the right price and with prompt delivery. The British cover their deficit whether or not they finance the shipments to France. Their interest in the matter is almost certain to flag. On the other hand, under the second of the two schemes the British find themselves extraordinarily dependent upon France. Their deficit with the United States is $100, but after receipt of aid they have only $50 in hand. Suppose now, they reason, the French decide that they can get the goods planned from Britain just as easily somewhere else, or that they can do without. In either event, the British cannot meet their dollar deficit. They evidently favor the first system. Under the IEPS, a forecast was made of prospective deficits and surpluses in intra-European trade; and countries likely to record deficits


were given drawing rights on the prospective surplus nations. This started out to follow the lines of our first alternative, which deprived surplus countries of incentive to make deliveries. An attempt was made to redress the incentives by making drawing rights “transferable,” i.e., permitting France, if it could not get the goods it needed from Britain, to transfer the drawing right, and with it the underlying aid in dollars, to a third country in Europe which could deliver. But this reversed the distortion rather than correcting it, and amounted to the same thing as financing total deficits, or the second alternative. The British objected strenuously to this method. European Payments Union The difficulty of finding a balanced system under which trade would flourish without distorted incentives led to the European Payments Union (EPU), which also tried to multilateralize all intra-European surpluses and deficits. Under this arrangement, in effect in July 1950, each of the member countries conducted its trade in Western European currencies, including the entire sterling area and French colonial area, through previously existing payments agreements. At the end of each month, however, the net balances of each country with every other were reported to the fiscal agent of the union—the Bank for International Settlements at Basle—which netted them. Each country was regarded as having claims on, or liabilities to, not the other separate members but the union as a whole. Accordingly, in
exporting to, or importing from, a member of the union, it made no difference from the point of view of foreign exchange which country was the trading partner. Within this area, the question of payments difficulties could be left out of account, and trade conducted on the basis of price, quality, delivery dates, and other commercial considerations. What of the net balance with the union, whether deficit or surplus? Here the attempt was made to discourage either type of imbalance, but deficits more than surpluses. Deficit countries received credit and paid gold (or dollars); surplus countries were asked to grant credit, but could receive partial payment in gold. Each country had a quota which was related to the total volume of its trade in Europe. The largest quota was $1,060 million for the sterling area; the next, the French, was $520 million. For the first fifth of a country’s quota, deficits were financed up to 90 percent by borrowing; surpluses entirely by lending. This was to reduce the total use of gold and dollars within narrow swings around balance. After this first fifth, however, deficits received 70, 60, 50, and 30 percent credit on successive fifths of its quota, and had to pay 30, 40, 50, and 70 percent, respectively, in gold. When the quota was completely used up, the debtor country was obliged to pay 100 percent in gold, exactly as if it had not belonged to the union. Surpluses were received, 50 percent in credit granted to the union and 50 percent in gold for all but the first fifth. The arithmetic of these declining credit receipts for debtors and constant
grants for creditors meant that EPU

had to have capital, which the United States provided; but, in the end, 40 percent of quotas

are credit for debtors and creditors alike. Multilateralization of European payments has been
accompanied by a liberalization of

trade restrictions on an organized basis. Countries were required to reduce trade barriers by

a given percentage of the total, starting with 50 percent, and advancing at stated intervals

to 60 and then to 75. There is an element of window dressing in this, of course, because the

least effective quotas are the ones first relaxed. But EPU stiffened the effect of this trade

liberalization by making mandatory removal of quotas in certain fields like textiles. When a country exhausts its quota in either direction, the managing board of the union

meets to advise it and to take action. Western Germany ran through its quota in the early

months of EPU, in a spurt of inventory accumulation touched off by the Korean war and

trade liberalization. EPU granted it a temporary additional quota, provided that credit was

restricted by the banking system and that trade was deliberalized. The medicine worked,

and Germany ultimately became a creditor. A series of specific criticisms has been levelled at EPU. In the first place, it is said that

EPU tends to make countries aim at multilateral balance within Europe and therefore, if

their total accounts balance, multilateral balance with all countries outside. This is true, and

it is hard on countries like Germany, which used to record surpluses within Europe needed
to pay for net deficits with other parts of the world. EPU also fails to solve the problems of the persistent debtors, which can close their deficits neither within nor without Europe, or those of the persistent creditors. The former must pay in gold or dollars when their credit is exhausted, or cut down on imports. Aus tria, Greece, and Turkey are nominally members of the union, but their persistent deficits must be supported by United States aid. The union has dealt with Belgium, the principal persistent creditor, with several expedients—a new credit, to be made available to other members, export restrictions taken by Belgium, and a funding of the Belgian credit by a loan from the International Monetary Fund. It has not been claimed that EPU can solve all problems. Its main achievement has been to multilateralize European payments for all but the persistent creditors and debtors, to assist in some considerable liberalization of European trade, and, most of all, to halt the disintegra tion of trade which had gone on before. For the last purpose, moreover, it is the best of the devices worked out, in that it is the least skewed in terms of incentives. But Europe cannot lift itself by its own bootstraps. This sort of European cooperation clears the way for a solu tion, but it does not solve the European payments problem with extra-European areas. Cooperation in Investment Programs An early feature of the European recovery program was sought in planned investment, particularly in dollar-earning and dollar-saving industries. The OEEC established a number
of committees and subcommittees in different sectors and industries, whose task was to

ascertain the scope of national plans in their own functional area and to rationalize these

in an economic way. It has not been possible to do much along these lines. Some particular investments in

oil-refining and steel fabrication have been prevented. These were outstanding examples of

duplication and autarchic planning. For the rest, little has been accomplished. This notion

ran afoul of the fact that the countries concerned relied in different degree on planning and

the price system. The countries devoted mainly to the latter could claim that they were in no

position to carry through any system or particular program. More important, perhaps, was

the fact that the countries participating were not basically prepared to yield their economic

sovereignty, at one blow, to an organization in which they had limited voice. The result was

that the OEEC served more as a clearinghouse for advising the other participating coun

tries of what progress and plans were in these separate fields of investment, than as a device

for coordinating. Such coordination as occurred emerged as a response of the separate

countries to what they learned in the OEEC and elsewhere.

Customs Union as a Recovery Measure

The United States has urged on many occasions that the participating countries form a customs union for the purpose of advancing European recovery. This was a view of Mr

William L. Clayton, who was undersecretary of state in the
United States when the Marshall Plan was being developed into the European Recovery Program; it was expressed by Congress in the preamble to the Economic Cooperation Act of 1948 and subsequent years;

and it was the subject of a major speech by Mr Paul L. Hoffman, ECA administrator, on 31 October 1949, in Paris. Customs union was supposed to assist in directing resources into export-increasing and import-decreasing industries, through merging national markets into a single European market and obviating waste of resources through duplication or uneconomic allocation of resources to earn or save dollars and other overseas scarce currencies in separate countries. Customs union also was believed likely to assist recovery by widening the scope of competition and preventing industries, or factors of production, from exercising monopoly power. The power of German industry, French peasants, or British government in the Coal Board to pass on increased costs in higher prices would have been reduced by the fear of attracting goods from other European countries. This would serve to spread the burdens of increased cost more widely and reduce the force of inflation. It has been pointed out that customs union would have an adverse effect on recovery insofar as purely European industries were concerned. While rationalization was needed of any new investment in export-or import-competing industry, new investment in rationalization of domestic industry would take capital which was not available. To the extent that customs union encouraged this sort of undertaking, it would
be inflationary and impede recovery. The most important objection to customs union, however, was that Europe was not ready for it. The sad example of Benelux, the projected economic union among Belgium, Luxemburg, and the Netherlands, testifies eloquently to this effect. An economic union is a customs union with added monetary union, or common currency. The three Low Countries agreed on such a union during the war through their governments in exile. Postwar governments reaffirmed the agreement and worked out a definite schedule of steps through which the union would be accomplished. As time went on, however, and considerable numbers of experts on each side worked on the problem, it appeared that neither country was really willing to go through with even the customs union. For the Dutch, it would have meant the liquidation of a considerable segment of the textile industry which would have been done by Belgian manufacturers. More significant, because it was the Belgians who finally vetoed the project, the fruition of Benelux would have meant a liquidation of important sections of Belgian agriculture which would have been undersold by Dutch farmers. The economics of customs union were examined in Chapter 14 [of International Economics, 1953], where we saw that not all customs unions increase the economic efficiency of the resources affected, judged from a world point of view. This objection hardly arises in the case of European customs union, since the resources concerned are competitive rather
than complementary and the removal of internal tariffs would reallocate resources in more economic fashion. If it could be done, it would increase the European standard of living, although the transitional effect might be inflationary if added capital investment were undertaken in a period of full employment. The Schuman Plan

As an alternative to general customs union, the French Foreign Minister, Robert Schuman, proposed in May 1950 that a customs union be adopted in coal and steel alone, along with provision for elimination of all discriminatory pricing and freight rates. The Schuman Plan, as this project became known, really lies outside the European Recovery Program. Great importance attached to its political by-products in a rapprochement between Germany and France: if France became dependent on German coking coal, Germany on Lorraine iron ore, with neither able to exploit the other, a considerable gain for European understanding and peace would have been made. The plan is also of long-run significance to European rearmament, since it involves the rationalization and increased efficiency of the steel industry. It is further true that steel is an export industry, and coal, in the postwar period, import-competing. But the Schuman Plan involves a project of European cooperation more closely linked to the program for a European army and the defense community under the North Atlantic Treaty Organization than to the European recovery program. The Schuman Plan raises interesting
problems of economic sovereignty. These must
be postponed to Chapter 27 [of International Economics, 1953]. Here it may be observed
merely that proceeding with customs union in one or two industries at a time has the advan
tage of reducing the number of hard cases where a country may be obliged, by the facts
of trade without protection, to liquidate a significant industry. Italian iron and steel, which
have been high-cost, are one example of this; Belgian coal mining, notoriously high-cost,
is another. The Schuman Plan contains transitional provisions which permit subsidization
for a period of five years. The Schuman Plan has intense interest as a solution to the problem of dual prices and
discriminatory freight rates. Dual pricing is eliminated, but some freight absorption or sale
on delivered pricing basis is permitted where so-called “natural” basing points are worked
out. But this subject is too complex to permit of development here. Division of Aid
Perhaps the most important contribution of the Western European countries as a group was one
which received little recognition—their willingness to make recommendations for the divi
sion of aid. The United States could have made its own calculations of the aid that European
countries were entitled to on the basis of their past and their prospects, economic and political.
Without any objective basis for making these decisions, they would have been objectionable
to at least half the countries of Europe, and, since some countries received more assistance
than others, probably to more than half. It required a considerable degree of cooperation for the countries of Europe to agree on relative shares, in the absence of objective criteria. Some doubtless felt that they gained rather than lost from the procedure, because their cause was better understood in Europe than in the United States. Others perhaps believed that they would lose. Possibly the majority of them considered that it was purely a matter of chance. The division of aid without objective economic or political criteria was a creative cooperative act, forced on Europe by the United States, no doubt, but none the less cooperative.

The type of sharing implied in this act is the basis of forging many into one sovereignty. Success of the Marshall Plan was unprecedented. The dire character of the need and the impressive success of 1948 were
both exaggerated by the bad and good harvests of 1947 and 1948, respectively. As a stopgap measure, its political implications in France and Italy especially were highly significant. As a self-liquidating device which would enable European countries to re-establish convertibility of currencies without further aid, it had still some distance to go when the rearmament program was added on top of it. Structural and secular disequilibrium are obdurate. Summary

The Marshall Plan illustrates all four types of disequilibrium—cyclical, secular, and structural at the goods and factor levels. The causes of this far-reaching disequilibrium are found not only in the war but also in the changed relationships between Europe and the rest of the world which were partly hidden during the 1930s by the depression. Foremost among these reasons are loss of domestic and overseas capital, increase of population, a change in social ideas about income distribution, the monetary and political chaos inherited from the war, and the change in terms of trade and political relations between Europe and the rest of the world. The goal of the recovery program was international balance at some level of consumption and investment which represented a combination of the historical, the desirable, and the feasible. Two alternative paths led to this goal: along one, domestic measures consisted of planning, allocation of resources, price and wage control, while import controls, export set-asides, and exchange supervision dealt with the foreign balance. Along the other,
domestic measures were monetary and fiscal restraint, high interest rates, control of the money supply, while internationally exchange rates were adjusted to the equilibrium level.

In both cases, foreign aid permitted faster recovery to a higher level. The relation between the scale of aid and the goal of recovery is one of interdependence.

The attempt to set the level of United States assistance by estimated balance-of-payments deficits involved circular reasoning. European cooperation in recovery meant various measures to maintain the level of intra-European trade, starting with offshore purchases, and followed successively by the Intra-European Payments Scheme and the European Payments Union. Also significant was trade liberalization. Progress toward customs union and coordination of investment programs was limited. An important aspect of cooperation was readiness to assume responsibility for the division of aid. The success of the European Recovery Program cannot be definitely judged. Suggested Reading Texts


The European Recovery Program is treated at great length in the quarterly reports of ECA and MSA, the many publications of the OEEC, including annual reports, in annual hearings before the Foreign Affairs and the Appropriations Committees of both houses of the Congress, in The Economist, the annual Reports of the BIS, and especially in the quarterly Bulletin and annual Surveys of the Economic Commission for Europe. Points

The article referred to by Fritz Machlup is “Three concepts of the balance of payments and the so-called dollar shortage,” Economic Journal (March 1950). For accounts of the impact of the war on capital, see W. Hancock and M. Gowing,

Britain’s War Economy (London: HMSO, 1949), and US Strategic Bombing Survey, The

Acheson, Dean (1969), Present at the Creation: My Years in the Department of State (New York: Norton).


This paper is based not on scholarly research, but on the reminiscences of a marginal participant in the events of 1945 to 1948. Such value as it may have is as source material, distorted by a narrow field of vision and imperfect memory. Apologies are due the reader for the presentation as “facts” of what is partly hearsay, which may have been controverted by information available at a higher vantage point, and for contemporary interpretations of which scholarly synthesis may already have disposed. The writer is an economist, not a historian, and is not abreast of the historiography on the subject. The cold war between the Allies and the Soviet Union broke out, at least in small skirmishes, long before the two parties won their military victory over Germany in May 1945.

United States veterans of the European Advisory Commission (EAC) in London, on which representatives of the Soviet Union, the United Kingdom, the United States, and, after a long battle, France were planning the postwar treatment of a defeated Germany, were over
whelmed by the difficulties of reaching agreement between the West and the Soviet Union.

Agreement with the Soviet Union was fairly readily achieved on the negative principles of the Morgenthau plan for a denazified, democratized, and de-industrialized Germany. The revelations of concentration camps overrun in Germany in the winter and early spring of 1945 reinforced the mood of non-fraternization with, and rigid suppression of, the Germans. It was difficult to get agreement on much else. With the termination of hostilities, the mood of suppression gave way to ambivalence—in the West. Germany needed to be punished for wrongdoing, but it was also essential to revive the German economy for its necessary contribution to European recovery. The stern pronunciation of the Joint Chiefs of Staff Directive 1067 (JCS 1067) that the United States commander should do nothing to restore the German economy above the minimum level necessary to prevent such disease and unrest as might endanger the occupation forces gave way in July 1945 to an order to stimulate coal production for export delivery to Belgium, the Netherlands, and France. The Western conflict between urges to suppress the German economy and to use it to assist Allied recovery was initially absent in the East. Soviet troops liberating German consumption goods were followed by industrial experts who ripped machinery, tools, and even electrical and plumbing fixtures out of German factories and loaded them on railroad cars for shipment east, even before the Reparations
Commission, appointed at Yalta, met in Moscow at the end of June 1945. Soviet recovery needed capital equipment which the German economy would provide, whether as war booty, called “war trophies” in Soviet terminology, as restitution, or as reparations. Since its zone of occupation was the German granary, the Soviet Union was unconcerned by any need to bring in supplies from outside to feed the Germans. Indeed, the Red Army lived off the German land, which was in better condition than the areas of the USSR recovered from the Wehrmacht. Practical circumstances and sharply divergent outlooks thus divided Soviet and Western views on dealing with the German economy. The Allied leaders (and the Reparations Commission) met in Potsdam in July. The agreement reached merely papered the cracks of disagreement: the Soviet Union received reparations in capital equipment from its zone of occupation in Germany, and some removals of equipment from the three zones in the West, in return for a commitment to treat the four occupation zones as a single economic unit. The essence of the commitment, at least in the United States view, was the so-called first-charge principle that imports into any zone of Germany should be a first charge against exports from current production from any zone, ranking in particular ahead of reparations out of current production. Mindful of the reparations arrangements after World War I, when United States investors loaned Germany
the foreign exchange to enable it to pay reparations to France and Britain, the United States

was concerned lest the Western Allies, and especially Britain and the United States, be

obliged to put food into their zones of occupation in Germany, while the Soviet Union was
taking it out in the East. How much capital equipment was to be removed from all zones in Germany was to be
determined by a level-of-industry agreement. The four military commanders were to deter
mine that level of capital equipment needed to enable Germany to produce a level of living
no higher than the average of all the neighbouring countries; capital equipment in excess of
this amount, especially that in prohibited industries, was to be dismantled and made avail
able for reparations on a zonal basis. Agreement was difficult, with Soviet representatives
pressing for lower and lower levels of permitted industry and the Western representatives,
with residual responsibility for feeding the Germans, for higher. In addition, implemen
tation of the agreement was one-sided. Soviet representatives had access to the Western
zones; Western forces were excluded from the Soviet occupation zone. The shift of attention from reparations to
recovery occurred in the Department of State shortly after Potsdam. It resulted in a declaration,
undertaken as a response to questions from the Department of War administering the occupation zone through the Office of Mili
tary Government, United States (OMGUS), which was published as a pamphlet, “Repara
tion Settlement and the Peacetime Economy of Germany.”
In the summer of 1945 the economic sections of the department also produced a proposal for an economic commission for Europe under the United Nations, in which the Soviet Union and the Eastern bloc would negotiate with Western Europe and the United States on European-wide recovery issues. The Economic Commission for Europe was started by amalgamating a series of ad hoc recovery agencies in Europe—the European Coal Coordinating Inland Transport Organization, and the Emergency Economic Committee for Europe. Its first meeting took place in May 1946. This was also the month in which General Clay halted reparation deliveries from the Western zones of occupation to the Soviet Union on the ground of its refusal to abide by the first-charge principle as it took reparations from its zone out of current production. Reparation deliveries of dismantled capital equipment went on for a while to the West, through the InterAllied Reparations Agency in Brussels, but ran downhill and were shortly stopped altogether. Subsequently voluntary reparation payments by Germany to Israel and by Japan to a number of the countries it had stripped during the war proved again that reparations can be produced and delivered if the defeated countries wish, but cannot be exacted. The Soviet Union shifted from reparations out of capital dismantlings to reparations out of current production because it lost interest in second-hand machinery. In the summer of
1945 visitors to that country reported seeing railroad yards with loaded flat cars of rusting machinery. The requisition of current output from Germany in violation of the Potsdam Agreement—though the most skilful negotiator would have been unable to make the Soviet representatives admit to a violation—was probably undertaken because the Soviet Union badly needed outside assistance, and there were no other sources of assistance available.

Lend-lease had been stopped in August 1945. The same summer the capital of the United States Export-Import Bank had been increased from $750 million to $3,750 million, as a stopgap measure until the entry into operation of the International Bank for Reconstruction and Development (IBRD) agreed upon internationally in 1944 at Bretton Woods. One-third of the $3 billion increase in the capital of the Export-Import Bank had been earmarked in congressional discussion for the Soviet Union. In the event, however, no such loan was made. The history of the episode is confused. In one account the Soviet Union failed to apply for a loan. In another the Foreign Economic Administration (FEA), which took over the work of the Lend-Lease Administration and the Board of Economic Warfare, “lost” the Soviet application. One rumor circulating at the time in Washington was that the FEA administrator, Leo Crowley, had exercised an independent pocket veto of the loan. The first agency established for postwar economic recovery by the United Nations was
the United Nations Relief and Rehabilitation Administration (UNRRA). Relief meant mainly food, clothing, medical supplies, shelter, and perhaps transport (trucks and gasoline). Rehabilitation implied any items of the foregoing list not included under relief, as well as reconstitution of depleted inventories of raw materials, components, and spare parts. After relief and rehabilitation came reconstruction, a task assigned for war-torn countries to the International Bank, and consisting largely of capital replacement to make up for damage by shot and shell and, of equal or greater importance, six years of accumulated depreciation. Once reconstruction had been accomplished, a normally functioning world economy was to be turned over to the IBRD for development, to the stillborn International Trade Organization to organize the normal functioning of world trade, and to the International Monetary Fund (IMF) to finance normal disequilibria in international payments. It should be noted parenthetically that the programme of UNRRA and the IBRD were not meant to apply to the United Kingdom, which was granted a special $3,750 million loan by the United States to stimulate its recovery to the point where it could play its customary pivotal role in world trade and payments. The rationale of this Anglo-American Financial Agreement of 1946, negotiated between Secretary of the Treasury F.M.Vinson and Undersecretary William L.Clayton, on one side, and Lord Keynes on the other, was
the key-currency principle which Professor John H. Williams of Harvard and the Federal Reserve Bank of New York had enunciated in opposing the Bretton Woods institutions, the IMF and the IBRD. In this view, it was fatuous to try to produce full recovery, high-level employment, and balance-of-payments equilibrium for every country in the world at once: one should concentrate on key currencies, especially the pound sterling, and let recovery spill over, spread, or trickle down to other countries. As so often happens when there is a sharp clash of opinion in economics, history blurs the intellectual outcome of the debate by doing both. 3 At Bretton Woods the Soviet Union had urged larger and larger quotas for itself in the IMF and the IBRD and then declined to join either agency. 4 In UNRRA the Soviet Union was technically a donor, rather than a recipient, although the Soviet quota amounted to only 1 or 2 percent of the first tranche, as compared with 72 percent, or $1,350 million, for the United States, 18 percent for Britain, 6 percent for Canada, and the rest scattered.

The UNRRA council held a meeting in London in August 1945, after Potsdam, and Under secretary Clayton represented the United States. The main item of business was to approve new monies for a second and equal tranche for relief and rehabilitation. Clayton experienced great difficulty in obtaining agreement on the second tranche. Canada dropped out altogether, preferring to make its aid available to the United Kingdom which was not
an UNRRA recipient. The United States took over its 6 percent. Britain was willing to go
along with the second tranche only if Italy and Austria were transferred from military relief,
where British responsibility ran closer to 50 percent, to UNRRA, where it amounted to 18.
As a price of its agreement, the Soviet Union insisted on the addition of two new recipi
ents of rehabilitation, Byelorussia and Ukraine, while continuing to be counted among the
donors. With only one vote in seventeen in the council, and upwards of three-quarters of the
cost, the United States had to spread the second tranche more thinly. The London UNRRA council meeting dealt a sad blow to multilateral aid. Clayton
resolved to discontinue UNRRA after the second tranche. Either weighted voting or agreed
principles of distribution would have sufficed to keep the international institution func
tioning; lacking both it was necessary to switch to a unilateral basis where the donor had
some control over the donation—a decision which many liberals failed to understand and
severely criticized. (Later in the Marshall Plan, aid was provided on the basis of a multi
lateral agreement between the United States and the Organization for European Economic
Cooperation [OEEC], plus separate bilateral agreements between each recipient and the
United States.) Nor was there any interest at the Department of State in a third tranche for
UNRRA. Instead, a post-UNRRA grant of aid was provided by the United States to a list
of countries which originally included Austria, Greece, Hungary, Italy, Poland, Trieste, and China. Yugoslavia disqualified itself as a recipient of United States aid by shooting down United States aircraft in 1946. A Department of Agriculture mission to Poland in the late summer of 1947 concluded that Poland did not need further relief and rehabilitation, a judgment which even at the time seemed coloured by the deterioration in political relations between Poland and the United States. Europe, however, had not recovered. In December 1946 the British came to Washington and stated that they could no longer support the burden of providing relief for their zone of occupation in Germany. The British and United States zones of occupation were then merged into a bizonal area, which made better economic and political sense than four separate zones, but emphasized the gulf between the Western occupying powers and the Soviet Union. The United States picked up most of the tab for support of the bizonal area—which later became a trizonal area with the inclusion of the French Zone—through a special appropriation for Government and Relief in Occupied Areas (GARIOA). In February 1947 the British returned to Washington to announce the necessity of terminating their aid to Greece. President Truman responded in March with the Truman Doctrine which provided for economic assistance, and military support, for Greece and Turkey. The military help for Greece was directed especially against guerrilla activity.
in support of local Communists along the northern frontier. Military assistance in Turkey consisted to a great extent in building a network of roads which brought strong economic benefits. The British difficulties were not the only ones in the winter and spring of 1947. Negotiations over the treaties with Germany and Austria were deadlocked at the Council of Foreign Ministers at Moscow. More important, it was one of the worst winters on record in northern and western Europe. British railroad and road transport was snowbound. Winter wheat was killed in French fields, and resown seed was washed away by spring floods. Given the fragile state of domestic production, country after country had to rely on imports, especially from the United States, but reserves of gold and dollars were being drawn down to the vanishing point. When the doors of the IBRD and the IMF had opened in the spring of 1947, the French had borrowed the limit from both organizations, even though neither institution had been established for crisis action. Desperate circumstances required desperate measures. By the fall of 1947 these funds were nearing exhaustion, the Dutch needed financial help, and post-UNRRA relief looked small in relation to the needs of Austria and Italy. Secretary of State George C.Marshall had returned from Moscow in April 1947 persuaded that Europe was on dead center and needed an initiative of some sort. Undersecretary Clayton came back from a trip to Europe in May convinced that the economic links between city and country were threatened with collapse, as
farmers hoarded food and urban

food distribution broke down. George Kennan, counsellor of the State Department and

chairman of the policy planning staff, was impressed by the separateness of approach of

each country as it sought the means to keep going. Assistant Secretary Dean Acheson had

developed the idea of a new approach in a speech at Delta, Mississippi, in May 1947. The

ideas were not original. New forms of aid and a new start were being discussed in the press

by Walter Lippmann, James Reston, and others. The result of all this was Marshall’s well-known speech of 5 June 1947. After a brief introduction, three paragraphs presented the economic views of Undersecretary Clayton.

There followed certain political passages representing Mr Kennan: Our policy is directed not against any country or doctrine but against hunger, poverty, desperation and chaos. Any government that is willing to assist in the task of recovery will find full cooperation. Any government which maneuvers to block the recovery of other countries cannot expect help from us. Furthermore, governments, political parties, or groups which seek to perpetuate human misery in order to profit from it politically or otherwise will encounter the opposition of the United States. There is a microhistory concerning the speech. The conventional wisdom, for example,

holds that Foreign Secretary Ernest Bevin reacted with alacrity to Marshall’s initiative. Not so. The speech was mailed by the British embassy in Washington, not telegraphed. It was ignored by the correspondents of The Times and The Economist, the British establishment in economic matters. Department of State staff who were acutely conscious of the significance of the speech found the four or five days until the
Foreign Secretary finally responded to the insistence of the Telegraph’s Malcolm Muggeridge and the BBC’s Leonard Miall long and unanimously agree that Bevin was slow, not fast, to perceive the opportunity.

This at last he did, calling a meeting in Paris of Foreign Ministers Georges Bidault and V.M. Molotov. It is easy to charge with hindsight that Secretary Marshall never wanted the Soviet Union to participate in the Marshall Plan. Certainly there was a sigh of relief when Molotov refused to play. The excuse, if my memory is correct, was that the American approach to the problem was wrong. Instead of asking Europe to work out a recovery plan, and then financing it if it approved, the United States should give Europe the money with no interest in how it was used and no strings attached. To insist on vetting the plans for spending the money was an unwarranted interference with a country’s internal affairs—or some such line. Fair enough, but expensive. Beggars can’t be choosers. He who pays the piper calls the tune. And similar folk sayings of which Mother Russia doubtless has an inexhaustible supply, as Vishinsky used to demonstrate on every occasion. The United States, however, was entirely sincere in saying that the plan was open to any cooperating country. The offer was regarded as one more (final?) test of the Soviet Union’s intentions toward Europe. If it joined, the operation of the Marshall Plan would be that much more difficult, but the Soviet
Union would have made a commitment and joined an international undertaking for recovery. If it opted out, the die would be cast. It opted out, and the die was cast. What the Machiavellis among us never understood was why the Soviet Union did not join the Marshall Plan and disrupt it, as they have done with many organizations. It would not cost anything, as quotas in the IMF and the IBRD would have done. It would have been simple to agree in principle and object in practice. The fear in Washington was that the Soviet bear might hug the Marshall Plan to death. Soviet abstention left the West free to operate its own recovery programme with the Soviet Union excluded at its own insistence. So far as I know, the documents and memoirs do not give an answer to this riddle. Perhaps it is to be found in the fear which seems to permeate the Soviet system, fear of contamination from exposure to Western ideas and artifacts. Should the Soviet Union join the Marshall Plan, the satellites would join too. After Molotov withdrew from Paris, Bevin and Bidault sponsored a conference to plan the European Recovery Program, inviting the countries of Eastern as well as Western Europe to Paris in July 1947. The Polish government turned to Moscow to ask if they might attend and were sternly turned down. The Czech government, however, accepted without asking and, when the Soviet Union objected, was obliged to withdraw its assent. This was one of the significant steps leading to the overthrow of the Czech government and the death of Jan Masaryk.
in March 1948, a tragic event

which played a large role in stimulating the Congress to pass the Economic Cooperation

Act of 1948 which enacted the Marshall Plan into law. The speculation is that the risks of

joining were too great for the Soviet Union. The Eastern bloc might succeed in putting a

spoke into the wheel of Western economic recovery, but it ran the danger of being infected

with capitalism and the Western type of democracy. The refusal of the Eastern European countries to participate in the Marshall Plan did

not, however, imply restriction of trade between East and West. Gradual restoration of East

West trade was explicitly envisaged and provided for in European plans, and these plans

enjoyed United States approval. 7 The deterioration of trade relations did not set in until the

invasion of South Korea from the north, and the escalation of defence expenditures in the

United States and the Soviet Union. The Battle Act is dated 1951, not 1948. Between post-UNRRA relief and the Economic Cooperation Act of 1948 it was neces

sary to provide interim aid for the countries which were running short of reserves until

the Marshall Plan could be formulated in Europe, agreed with the executive branch of the

United States government, enacted into law by the Congress, and the funds appropriated.

All this had been accomplished by 3 April 1948. The first Marshall Plan appropriations,

though scheduled to last for the fifteen months from 1 April 1948 to 30 June 1949, were

expended, with congressional approval, within the plan’s
first year. Another turning point in international economic relations was marked when Undersecretary Clayton and Ambassador Lewis W. Douglas called on Foreign Secretary Bevin in the summer of 1947. The Foreign Secretary suggested that the United States should provide a large infusion of resources for the United Kingdom, and that the two countries, the United States and the United Kingdom, would then become benefactors of the Continent. But Clayton and Douglas were not interested in continuing the key-currency experiment, just as Britain was finding it necessary to give up the convertibility undertaken in July 1947 as a condition of the Anglo-American Financial Agreement of 1946, and the suggestion was turned down. There remains one more aspect of the clash between the United States and the Soviet Union over economic recovery in Europe, viz. the question of German monetary reform. Outsiders, conscious of the three years which elapsed between victory over Germany and the introduction of a new currency in June 1948, sometimes tend to regard the United States as dilatory in attacking this essential element of recovery. It is true nothing was done in the summer of 1945 when the JCS 1067 minimum recovery or even chaos school was in the saddle. When emphasis shifted to recovery, however, the United States was the leader in proposing a programme for currency reform. Gerhard Colm and Raymond W. Goldsmith, two distinguished economists who had been through the German inflation of 1922–3 before
emigrating to the United States, joined with Joseph Dodge, a banker of the financial division of OMGUS, to write the brilliant Colm-Dodge-Goldsmith report. This called for a 10 to 1 conversion of all currency, deposits, and debts denominated in money, plus a mortgage of 50 percent on all equities, including property owned outright, to equalize the burden of war losses. The purpose, of course, was to shrink the money supply to a point where price control could be abandoned without prices skyrocketing, and to control the redistribution of income from inflation so as not to wipe out the middle class in favour of profiteers, as had happened in 1923 with the resulting great damage to the fabric of German democracy. There were technical time-consuming problems, such as the printing of the new currency, which would take six months under the best of circumstances, and the question of whether to print it at the Reichsdruckerei, located in the Soviet sector of Berlin. But the major obstacle was Soviet resistance to the introduction of the new money into the Soviet zone of occupation or the Soviet sector of Berlin, despite the agreement to treat Germany as a single economic unit. United States economists in the Austrian Control Council had achieved a brilliant coup in imposing on the Austrian economy a single currency which was controlled by the council, thus giving the Western powers control over Soviet expenditure in the Russian zone of occupation. Brilliant in Austria, the coup was expensive in Germany,
where Soviet representatives refused to be caught again by what appeared to be a technical decision. In addition, all parties recognized that the issuance of money is a critical dimension of sovereignty. Two monies may well mean two sovereignties. The Western powers delayed as long as possible with monetary reform. But with the Marshall Plan about to begin, and with the new possibilities of recovery for Western Germany and Western Europe, it provided, action was necessary. The introduction of the new money into the trizonal area alone might have delayed the break with the Soviet Union, but would have opened a gulf between the Western sectors of Berlin and the trizonal area. The monetary conversion was therefore undertaken in both the Western sectors of Berlin and the trizonal area. Blockade and the airlift followed. Just as the effect of the Marshall Plan on the economic recovery of Europe was exaggerated by the severe winter of 1947 and the good harvest of 1948, so the response of German production to monetary reform was distorted. Monetary reform and the clearing away of price controls produced the Wirtschaftswunder, or economic miracle, by restoring incentives to work and to buy goods and services in the open market at remunerative prices. But production statistics exaggerate the recovery since output had been going forward, although unreported and into hoarding. The initial impact of the reform was to turn the black market white and to bring goods out of the back room into the
front window. Incidentally, the Lastensausgleich, or mortgage for the equalization of war losses, which the monetary reformers wanted to impose as an act of the occupying authorities so as to relieve the new democratic government of the heavy onus of what was considered to be an unpopular redistribution of wealth, did not go into effect until later. It was vetoed by the United States Secretary of War on the ground that all capital levies were bad, no matter how good the purpose, and that if the United States government were to start off on a course of capital levies in Germany, the policy might spread to North America. As it turned out, however, the new German government had no hesitation in imposing the Lastensausgleich as one of its first acts after getting power from the occupation authorities. Thus far, the example has not been contagious. The impact of the success of the Marshall Plan on the cold war is another story which goes beyond 1948 and the writer’s direct knowledge. There can be no doubt, however, that economic recovery was a powerful force in stabilizing political life in Western Europe and in halting the advance of Communist parties and Soviet influence. In 1956 the combination of economic recovery in the West and repression in the East produced cracks in the Eastern bloc monolith. Physics has always enjoyed great kudos as a science which spent $2 bil lion to test a theory about atomic fission and prove it. In the Marshall Plan, the economics profession got an opportunity to spend $17 billion to test a theory about the relationships
between economic dislocation and political behavior. This experiment, too, was a success. Notes

1 No. 201 in a useful compilation of documents, A Decade of American Foreign Policy: Basic Documents, 1941-49, prepared at the request of the Senate Committee on Foreign Relations by the staff of the committee and the Department of State, 81st Congress, 1st Session, Senate Document No. 123 (Washington, DC: United States Government Printing Office, 1950).

2 I vividly recall the absence of instructions from the Departments of State or War authorizing the halt of reparation deliveries to the Soviet Union and doubt that any will be found in the field. One of my colleagues from the political side of the department, however, has hinted to me that Secretary of State James F. Byrnes, in Paris attending a meeting of the Council of Foreign Ministers called to discuss the satellite treaties, authorized the action by telephone. In retrospect, the decision was a correct one, although Byrnes and Clay were probably less inclined to seek accommodation than their economic staffs. (The same was not true of the political staffs who had a long record of frustration in dealing with the Russians in the EAC.) But some of Byrnes’s vest-pocket decisions, made without staff work, proved to be serious errors, the halting of lend-lease in August 1945, for example.

Incidentally, it is of some interest to observe that the strategy of seeking to settle the satellite treaties first to clear the ground for the major German and Austrian treaties was devised by Benjamin Cohen, counsellor of the Department of State. For a time I thought it would have been better to tackle the big difficult issues first before attitudes had had a chance to harden. In retrospect, again, I doubt that any different strategy would have helped much.

3 Other examples of what I modestly call “Kindleberger’s historical law of alternatives” which readily come to mind are the debate in Britain in 1931 over whether to devalue or to apply tariffs; the division of opinion during the war between British and American bombing staffs over whether to attack the French railroads by pounding them to pieces at marshalling yards or to push the railheads back from the battle by destroying a system of bridges across the Seine and the Loire, plus a systematic series of intervening lines, the so-called system of interdiction; and whether the way to recovery after a major disaster like war lay
through planning or the restoration of free markets and price incentives. There is usually enough evidence on both sides after the event to satisfy all participants.

4 Soviet thought processes in some of these matters puzzled unsophisticated economists. An economic representative of OMGUS, chiding his Soviet colleague for having failed to attend a party after accepting an invitation to it, was startled to have the latter say: “I am sorry it happened, but let me tell you how you can get even. We will give a big party; you accept; and then you don't come.”

5 The period from February to May was particularly critical for food distribution in the years 1945 to 1948 because of the difficulty of spreading a short harvest evenly over twelve months. In Germany, in particular, wheat and bread became short in February, pending the new harvest. In some years it was necessary to substitute maize for wheat, despite the incapacity of German millers, bakers, and consumers to cope with it.

6 A Decade of American Foreign Policy, no. 300.

7 ibid., pp. 1294–5, Message of the President to Congress, 19 December 1947.

8 The fear was that the Soviet Union would get hold of a large supply of the new currency and spend it in the interest of obtaining real resources and stimulating inflation. In part, also, Western critics misunderstood the historical importance of the decision of 1945 to give the plates for printing the occupation currency to the Soviet Union. The United States lost several hundred million dollars through redeeming Reichsmarks and German occupation currency, and this was attributed by the ignorant to the fact that Undersecretary of the Treasury Harry D. White and Secretary Henry Morgenthau had made the Allied plates available to the Soviet forces. The error, however, was in redeeming German currency in dollars. The MacArthur command lost a couple of hundred million dollars this way in Japan, where there were no Soviet occupation forces. Not one dollar was lost in Italy, where an economist who understood these matters was in charge. See Frank A. Southard, The Finances of European Liberation with Special Reference to Italy (New York: King's Crown Press for the Carnegie Endowment for International Peace, 1946).

The shoddy history of how military finance lost close to half a billion dollars through ineptitude and squeezed it
back out of the German and Japanese economies and occupation personnel has not been told, possibly because many of the Treasury critics of the military were discredited as witnesses. An historical account by Vladimir Petrov—Money and Conquest: Allied Occupation Currencies in World War II (Baltimore, Md: Johns Hopkins University Press, 1967)—has not been seen but is reported, in a note in the Economic Journal, vol. 78, no. 309 (March 1968), p. 223, to be journalistic, inadequately analytical, and to repeat the error about giving the plates to the Russians.
7 1973 An Excerpt from an Oral History, Truman Library


8 1978 The OECD and the Third World


Many young people in the United States today believe that age 30, rather than 18 or 21,

marks the rites of passage from youth to adulthood. Thirty years is also the standard length

of a full generation. On the thirtieth anniversary of the conception or birth of the Organizat

ation for Economic Cooperation and Development (OECD), therefore, it may be useful

to look at the history of the organization, its present problems, and to peer briefly into the

uncertain future. My assignment is to undertake these tasks with respect to the so-called

Third World, often referred to as developing countries, the South, or LDCs. To a small

degree, it should be noted, this is an intra-OECD topic as well as one of external relations,

insofar as parts of some countries, notably Southern Italy, and all of others, i.e. Greece

and Turkey, in 1947, and today Portugal, belong to the category of developing countries or

regions rather than developed. History

At the end of World War II there were two views of how to deal with world economic

problems, the dominant global approach, embodied in the United Nations (UN), the
United Nations Relief and Rehabilitation Administration (UNRRA), the abortive Inter
national Trade Organization (ITO), later replaced by the General Agreement on Tariffs
and Trade (GATT), the International Bank for Reconstruction and Development (IBRD),
and the International Monetary Fund (IMF), not to mention specialized agencies in food,
health, education, weather, aviation, etc.; and the so-called key-currency, or key-country
approach, that recommended if not relieving and rehabilitating, at least reconstructing and
developing one country at a time, in an order that started a process that spread from the
center out. The key-currency approach was enunciated mainly by John H. Williams in his
testimony before Congress in opposition to the Bretton Woods agreement, and especially
to the IMF. 1 As a United States member of the Preparatory Commission of the League of
Nations for the World Economic Conference of 1933, he had advanced the key-country
notion as early as 1932. 2 The contrast between the global and the key-country notion is
similar to that between “balanced” and “unbalanced” growth. Balanced growth is summed
up in the view of the London Economist some time ago, that because of interdependencies
among industries, demand creating supply, and supply creating demand, “you cannot do
anything until you do everything.” 3 In contrast, unbalanced growth as enunciated by Albert
Hirschman is a theory that rests on the proposition that one thing leads to another, and that
economic recovery and development are best achieved by breaking successive bottlenecks,

each bottleneck being obvious at a given time, and its breaking leading to more recovery

and growth through what Hirschman called “linkages.” 4 As often happens when two diametrically opposed policies come into contention, the

world blurs the experiment needed to determine which is correct by undertaking both

simultaneously. The UN was created, and UNRRA, the IBRD, GATT, and the IMF, but

along with these global organizations, there followed an Anglo-American Financial Agree

ment in 1946, covering a $3,750,000,000 loan from the United States to the United King

dom for the purpose of restoring convertibility to the pound sterling, a key currency. This

experiment was unsuccessful, and convertibility was ultimately abandoned in July 1947.

The winter of 1946–7 revealed, however, that the global approach of UNRRA, post-UN

RRA relief, together with the initial credits advanced to Europe by the IBRD and the IMF,

would also prove inadequate. A new effort was necessary, and this, the Marshall Plan,

based on Secretary George C.Marshall’s speech of June 1947, was another key-country, or

rather key-region, proposal, seeking to restore world recovery and ultimately development

through the recovery of a strategic continent. There were echoes of a key-country approach

within the key region: it is not generally remembered that when William L.Clayton and
Lewis Douglas visited the British Foreign Secretary Ernest Bevin on behalf of the United States on 24 June 1947, Mr Bevin proposed that the Marshall Plan be applied first to Britain, and then by Britain and the United States in partnership to the Continent of Europe. 5

The “special relationship” between the United Kingdom and the United States proved not to be this special. The Third World entered into the initial European Recovery Program in various ways.

As noted above, there was an internal Third World component. The program that the Italian government had for its South—including the ten-year Vanoni Plan for economic development and the investments of the Cassa del Mezzogiorno—was folded into the recovery effort of that country. Greece and Turkey were included in industrial Europe. This last is largely the result of historical accident. In February 1947, President Truman had enunciated a program of defense for Greece and Turkey which were under pressure from infiltrating Communist forces and the Soviet Union, respectively, and which, in the case of Greece, the United Kingdom was no longer able to assist. The so-called Truman Plan was largely military in purpose and outline, though the program of road construction in Turkey had an economic component insofar as roads designed for moving troops and materiel also served, with limited extension, to connect farm and market. But the Truman Plan was unpopular in the United States. It was regarded as negative, rather than positive. A clear domestic politi
cal gain was achieved by consolidating the military plans for Greece and Turkey into the
wider European recovery effort. Economic recovery is a somewhat ambivalent concept. In its objectives, the
Marshall
Plan was a highly practical mixture of restoring the status quo ante and correcting it to the
extent it was unsatisfactory, both within the limits of feasibility. For Southern Italy, Greece,
and Turkey the Marshall Plan represented development rather than reconstruction. Profes
sor Gottfried Haberler of Harvard University enjoyed telling the story that when the Turk
ish delegate to the first Organization for European Economic Cooperation (OEEC) meeting
brought in his country's request for assistance, he was taken aside by the United States
representative, and told that the program was excessively modest and should be increased.

Similar technical assistance was not required of the more developed countries, anxious to
return as quickly as possible to old standards of living. On the contrary, the $30 billion in
the initial calculation of needs was scaled down by Messrs Clayton and Douglas to $16 bil
lion, a figure believed to come more nearly within United States capabilities. The OEEC plans did not explicitly provide safeguards against “backwash effects,” such
as was later done in the Treaty of Rome setting up the European Economic Community
of the Six. Like customs unions, stimulated recovery has largely benign effects on trading
partners, and on separate regions within them. Under certain circumstances, however, it can
be harmful by drawing away resources from the periphery, or diverting demand elsewhere.

The Treaty of Rome established a European Social Fund, a European Investment Bank, and an Overseas Investment Fund to meet the problems of particular regions or sectors within member countries or former colonies, that were adversely affected by recovery at the center. This impact of recovery in Europe in the early days of the Marshall Plan seems not to have been so powerful. On the contrary, under the so-called (W. Arthur) Lewis model of “growth with unlimited supplies of labor,” the movement of disguised unemployed labor from, say, the agricultural to the industrial sector stimulates both. Given an initial increase in demand or reduction in costs, the industrial sector gains from massive inward transfers of labor through the expansion of production without sharp increases in wages; in turn, the agricultural sector gains in income per capita of those remaining, since output drops less than the input of labor, if at all, and farmers may find it worthwhile to invest in machinery and new productive methods. 6 The Europe of 1947 was very different from that of 1939 in its relations with large sections of Asia and Africa, and some portions of South and Central America, plus the West Indies, which had been dependent on European powers. Colonial ties were breaking or were about to break. The economic impact of this process was misperceived on both sides. The European colonial powers thought that they would suffer
great economic losses from the

independence of their former possessions. At the same time, the former colonies believed

for more than a decade that throwing off the economic exactions of Europe would make

then instantly rich. The notion was a familiar one. Germany had complained about the loss

of its colonies under the Treaty of Versailles until the eve of World War II. In addition, the

occupying powers and West Germany thought after World War II that West Germany would

go hungry because of the loss of grain-producing areas of Pomerania, Brandenburg, Mecklenburg, and East Prussia behind the Iron Curtain. Neither of these primitive ideas rooted in

the fallacy of misplaced concreteness had much validity. On the whole, and with only a few

exceptions such as the Belgian Congo, colonies were a net burden to their European mas ters. The richest countries in Europe, Sweden and Switzerland, were not colonial powers.

The loss of the grain-producing areas of Eastern Germany improved, rather than worsened,

the economic position of West Germany over time by allowing it to buy cheap world wheat

instead of the heavily protected and inefficiently produced cereals from the East. The failure of independence to bring instant wealth to former European colonies had

a more sustained impact. In due course, the notion developed that political differed from

economic independence, and that the former did not necessarily lead to the latter. In place

of imperialism and colonialism, political independence might bring only neo-imperialism
and neo-colonialism, or dependencia suffered also by the many countries of Latin America which obtained political independence from Spain and Portugal early in the nineteenth century. These last notions were vague in outline and content. It was not clear how they applied separately to the varied experience with decolonization of Britain, which granted independence to large segments of Asia and Africa, after having prepared them for it in varying degrees: to Belgium and the Netherlands which were expelled from the Congo (Zaire) and the former Netherlands East Indies (Indonesia) respectively, and to France which replaced colonial ties with most of its African colonies with voluntary support for administration and especially teaching, as foreign aid, or perhaps in exchange for continued adherence to the francophone area, but was belatedly and forcibly expelled from Algeria in Africa and Indo-China in the Far East. A significant relation between Europe and the Third World involved in the key recovery of Europe turned on the complex monetary connections between former colonies and dependent states with France to some degree, but especially with Britain. Under the Anglo-American Financial Agreement, Britain had agreed to seek to scale down and/or to fund into long-term debt the large sterling debts represented by the accumulations of its currency by dependent allies in payment for troops and for services provided to troops, notably by India, Egypt, Iran, and Iraq. The independent members of the British
Commonwealth—Canada, Australia, New Zealand, and the Union of South Africa—had voluntarily reduced their accumulated wartime claims on Britain, and the settlement of Britain’s lend-lease obligations to the United States had been readily achieved. Reduction and forced funding of the claims of dependent territories and less developed countries proved more difficult, for Britain to propose as it would have been for the countries concerned to accept. In consequence, Britain failed even to negotiate with these countries. Under the Marshall Plan, no new pressure was applied to the settlement of these debts, but the recovery experienced by Europe, plus the extension of the sterling area in other directions, enabled a start to be made in paying them off. The extension of the sterling area through the currency boards of former African colonies such as Ghana, or independent Malaysia—the former Malay States—has been misinterpreted, even by such a distinguished economist as Dennis Robertson. The monetary systems of many of these colonies, not always replaced by central banks when they became independent, rested on the issuance of domestic currency on a one-for-one basis against a reserve of sterling balances held in London. Numerous observers like Robertson believed that Britain was exploiting these colonies by requiring them to lend to it in order to obtain money for use within the colony. But the money supply could be expanded otherwise than by building an export surplus into holdings of sterling. Sterling could be acquired as well
by borrowing. Many of these colonies, later independent
countries, borrowed in London,
held the proceeds in sterling securities and balances, and
issued new money against these
holdings. Such a system involved little expense—the
difference between the cost of bor
rowing and the return on government securities and
balances—and had the advantage of
funding an import surplus, should one occur, in advance.
One further financial connection ran between the Marshall
Plan and the Third World, and
afforded an interesting parallel between the British loan
and the European Payments Union
(EPU), both representing key-currency approaches to world
recovery. The EPU of 1950,
it will be recalled, was a device to prevent decline in
intra-European trade arising from the
attempts of various countries in Europe to earn dollars
from one another to pay for imports
from the United States. Supported by an initial credit from
Marshall Plan funds, and by
subventions from the United States to make up the cash
required of persistent debtors, it
enabled the participants to balance their accounts overall
in Europe, giving and receiving
credit, along with dollars, and eliminated the incentive to
build surpluses in Europe to pay
for deficits outside, an incentive that was leading
progressively to declines in imports and
in total intra-European trade. But balancing trade with
Europe would not have been opti
mal from a world point of view. I forebear from tedious
demonstration of this proposition,
except by reference to the well-known studies of Folke Hilgerdt, *The Network of World Trade* and *Europe's Trade*, written for the League of Nations as part of that institution’s preparation for the postwar. Hilgerdt showed that some countries like Germany typically earned surpluses within Europe needed to pay for net imports from overseas areas, whereas others, like Britain, had large export surpluses in extra-European trade that, together with overseas investment income, enabled them to repute import surpluses with the United States and Western Europe. To force intra-European current payments into balance would distort this efficient pattern of multilateral balancing. The way out of the dilemma was to enlarge the concept of European trade to include sterling and francarea payments within the framework of the EPU, along with those of Britain and France. By this act, the bulk of world payments outside of dollars were included in European settlements, and the distortion to world payments theoretically implicit in EPU was minimized. Finally, in the early history of the Marshall Plan, it is well to note an ambiguity that has persisted over the full thirty years of the relations within Europe and those between the OECD countries and the Third World. To the Americans, and especially to Messrs Clayton and Douglas, the purpose of the Marshall Plan was to restore the economies of Europe to the point where free markets could function efficiently. These ideas were also held strongly by the Germans under the leadership of
Adenauer and Erhard. To much of the rest of Europe, however, and implicit in some of the language of Secretary Marshall’s speech and in the presentation made by the Department of State to the Congress, the Marshall Plan represented a move by Europe to international economic planning with the aid of outside resources provided by the United States. The OEEC report and the Department of State documents which projected the balances of payments of seventeen countries for years, specifically noting exports and imports within Europe and with the outside world in twenty-six separate commodities or commodity groups, bespoke planning. The emphasis given by Clayton and Douglas and later by Paul Hoffman to larger markets, reduced discrimination, abolition of quotas, and the like moved in the direction of free markets. A quarter of a century later the issue had not been fully resolved. The French government proposed, albeit in the vaguest of terms, that the New International Economic Order demanded by the Third World should represent an attempt at world planning for prices and quantities of commodities, balances of payments, foreign aid, and other magnitudes in international economic relations, this at the same time when French internal planning had lost some of its mystique and planification was giving way to déplanification. A major shift occurred in 1951 when the Labour Party under Attlee was defeated in Britain and was replaced by a Conservative government. Labour had embraced a policy of
international commodity agreements in which governments would commit themselves to buying or selling given quantities of particular products at stated prices over periods as long as five years. In theory, such arrangements provided assurances for the buyer that it could obtain desired supplies, and for the seller that it had certain outlets. So highly prized were the latter regarded in Britain, as a result of the experience of the depression, that it was felt that the seller could afford, with assured outlets, to undertake cost-reducing investments and to sell at below-world-market prices. The outbreak of the war in Korea gave a sharp boost to raw-material and food prices, and ended the interest of suppliers in such arrangements. Countries such as Denmark and Argentina that supplied large quantities of foodstuffs to Britain under commodity agreements felt aggrieved that their prices were held down by agreements with time still to run, when those of the rest of the world moved sharply upward. Britain was asked for voluntary adjustment and refused it. The international commodity agreements were unlikely to have been renewed by the supplying nations, had not the Conservative victory ended the policy in favor of freer markets. The Korean war dampened the complaints of the LDCs, led by the brilliant Executive Secretary of the Economic Commission for Latin America, Raúl Prebisch, that the terms of trade were moving inexorably against developing countries. At the same time it made them impatient with international
commodity arrangements that held prices down rather than up. In the initial OEEC stage, perhaps the only sector that was thoroughly planned was that of petroleum, where governments depended for guidance on the international oil companies.

It did not last long. Neither the European Coal and Steel Community (ECSC), which sought to plan coal from 1950 but fell back finally on national solutions before being absorbed into the EEC, nor the OECD, ever succeeded in the postwar period in achieving a coherent energy policy. In oil the initial start by the companies gave way before divergent Italian and French policies, that sought to establish national companies, serving national political as well as economic interests. In particular, France staked heavily on buying high-cost Algerian oil through its national companies, rather than cheaper Middle East oil sold by American and British companies. Ultimate independence for Algeria in 1961 raised questions as to the wisdom of the policy. The failure of the EEC and the OECD to achieve unity on energy foreshadowed the chaotic response to the Yom Kippur embargo of November 1973, discussed below. An unsuspected contribution of the early OEEC period to today’s Third World, recently mentioned by Hollis Chenery at the Eastern Economic Association Hartford meeting in April 1977, lay in the development in Southern Italy, Greece, and Turkey of techniques for guiding national economic growth. Requests for aid under the Marshall Plan were required to stress the uses to which it would be put, and to couch
the statement in terms of nation

al-income accounts that were just coming into general use in the framing of economic policies. The Cassa del Mezzogiorno that carried out development policies in Southern Italy under the Vanoni plan was furnished with Marshall Plan counterpart funds, arising from the sales of delivered goods. The IBRD was embarking slowly on project planning.

The OEEC pioneered in program planning for economic development inside Europe, to
develop techniques of later worldwide significance. The OECD Period

The conversion of the OEEC to the Organization for Economic Cooperation and Development (OECD) in 1960 marked a new stage in Europe’s external economic relations.

Symbolically, the word “Europe” was eliminated from the organization’s title; the word “development” was added. The key region was changed to a key class, developed countries,

inclusive of the United States, Canada, Japan, and later Australia and New Zealand, creating perhaps a precedent that countries might develop sufficiently to be graduated into OECD ranks. 10 The European mantle of the OEEC was taken over by the EEC, later enlarged from the Six to the Nine. Much of the time of the OECD was engaged in the work, of great importance for the developing world, of planning macro-economic policy among developed countries so as to sustain world income. Along with the EEC it concerned itself with North
South European problems, such as the regulation of migration from the Mediterranean littoral to the industrialized countries of Europe. In the majority of its work, however, dealing with trade, aid, technology, and the multinational corporation, it found itself centrally concerned with issues of world development. In trade, the OECD occupied only a portion of the world stage, sharing it with GATT and the United Nations Conference on Trade and Development (UNCTAD). In development, again, the major role was assigned to the IBRD and its fellow organizations, the International Development Agency (IDA) for soft loans and the International Finance Corporation (IFC) for equity finance; to the regional development banks for Asia, Africa, and Latin America; and to United Nations agencies such as the UN Development Programme (UNDP). OECD’s role in the multinational corporation was shared, to a degree, by the United Nations Commission on the Transnational Corporation.

In monitoring aid, the Development Assistance Committee (DAC) of the OECD operated largely alone. To provide support to its own developing members, the OECD established a special programme, which during the 1960s rendered classical technical assistance along the lines of other international and national organizations. Latterly this program has been transformed to undertake a more distinctively cooperative approach as a tangible expression of solidarity between industrialized and industrializing countries. So far as I am aware,
the Organization played no particular role in discussion of the so-called “link,” i.e. the link

ing of issues of new international money (Special Drawing Rights or SDRs) to foreign aid,

to make the “seignorage” from the issuance of international money available to the develop

countries. These issues were discussed in the special circuit of experts dealing with

purely monetary issues—the Group of 10, the IMF, the Bank for International Settlements,

and most recently the twenty-seven-country Conference on International Economic Coop

eration which is also seized with several other topics on the development agenda: stabiliza

tion of international commodity prices, compensation for fluctuations in export proceeds,

and, an issue raised by the Group of 77 (actually 113 countries) at its Manila meeting in

May 1976, rescheduling of the international debts of developing nations. The issue of North-South trade continued to play a role in OECD deliberations after

the developing countries became disenchanted with GATT, and founded their own United

Nations Conference on Trade and Development (UNCTAD), that first met in Delhi in 1964.

This left GATT more or less a rich man’s club, although some developing countries contin

for developing countries as an exception to the GATT rules of non-discrimination and

States and the EEC, and of discussion primarily in GATT but also in the OECD. The prefer

ences that the United States objected to were those accorded to former European colonies
in the EEC. These were most significant in the period before Britain joined the Common

whole, and especially in Germany, at the expense of former British colonies in Africa and

the less developed countries of Latin America. The United States also found objectionable

the extension of the EEC from the Six to the Nine, and reductions in tariffs under the Ken

nedy Round, these issues lost critical significance. At Lomé the arrangements concluded

between the enlarged EEC and former colonies provided compensation on the grounds of

in manufactured products in favor of developing countries. They were generalized because

they applied in principle to all developing countries—though the line between developed

and developing countries was difficult to draw—and not just to those with particular politi

cal associations. For a long time the developed countries resisted the demand on the ground

of the principle of non-discrimination, until finally one by one they conceded, the United

States and Germany giving up last. The concessions were surrounded with such limitations

Import quotas, tariff items held out of the bargaining of the Dillon, Kennedy, and the con

tinuing Nixon rounds of GATT multilateral negotiations, the special agreements for export

limitations in textiles, and especially the provision of the Kennedy Round that allowed for

free trade only in tariff categories produced 80 percent by a limited list of countries—the

EEC and the United States—made very apparent that the developed countries were unwilling
ing to reduce tariffs seriously, if at all, in the
labor-intensive products that developing coun-
tries had a chance of producing cheaply for export to world
markets. As it happened, the 80 percent provision of the
Kennedy Round authorizations amounted
to very little when President de Gaulle vetoed British
admission to the Common Market in
January 1963. Without Britain as a member of the EEC, very
few items qualified for 100
percent reduction. The legislation nonetheless revealed the
reluctance of the developed
countries to make a place for imports competitive with the
lower-paid workers in their
societies. The issue was internal to the OECD countries as
well as between them and the
members of UNCTAD, as difficulties in making a place for
Japanese manufactured exports
reduced tariffs, insofar as they permit countries to
maintain substantial levels of protection
for their inefficiently allocated resources, if somewhat
less protection for developing than
for developed competitors. Adopted as an expedient of
realpolitik, it has become defused
as an issue because of its limited application, and the
more pressing issues of resisting tariff
and quota increases. The OECD role was much larger in
foreign aid, the multinational corporation, and
In aid, the DAC played largely an informational role, compiling data, making comparisons,
publishing annual reports, and discussing subjects of
interest to donors. It endorsed the
UNCTAD target that developed countries should make
available in total flows to economic
development 1 percent of gross national product, later supplemented by the target of 0.7 percent for official aid as defined by DAC in the more meaningful but still excessively ambitious demand of the Group of 77 and in the UN resolutions of the Second Development Decade. It also pressed hard, and with some success, for softer financial terms. Utopian critics could easily find fault with the work of DAC, which in its early stages appeared to accept as “aid” virtually everything that the member countries chose to regard as aid. In theory, there is a continuum between a strictly commercial transaction, with no element of aid, and a pure gift, with no element of quid pro quo which is aid. Every transaction between North and South could find a place on this continuum and the proportion of aid to “business” could be theoretically at least calculated. DAC included with aid some German short-term commercial credits to developing countries at market rates of interest, and French support for former colonies in the Communauté that represented an attempt to maintain close administrative and cultural ties between these countries and France, and were part of foreign policy rather than disinterested assistance. Admittedly the distinctions are difficult to draw. A similar Utopian objection could be leveled at the proportional target of foreign aid by developed countries which failed to take account of either income per capita or of relative contributions to other approved international undertakings. Inter national income redistribution is clearly at a very
rudimentary stage. Like the celebrated
woman preacher of Dr Johnson or the dog of Mark Twain that
walked on its hind legs, the
OECD is perhaps more properly applauded for doing it at all
than for its crude and unso
phisticated performance. In the multinational corporation,
the OECD has proceeded slowly. In 1976 it produced a
code of conduct, voluntary rather than mandatory, and
dealing essentially with problems of
corporate subsidiaries in developed countries—questions of
anti-trust, taxation, obligations
with respect to employment, illegal payments, and the like. The range of issues is differ
ent from those discussed in UNCTAD, which has been
concerned with restrictive business
practices, the patent system, and the limitations imposed
by head offices on their subsidiar
ies to export; and from those dealt with by the UN Assembly
which has passed a number of
resolutions concerning the permanent sovereignty of
developing countries over their own
resources, the inherent right of countries to renegotiate
outstanding contracts when they so
choose, and which finally established a UN Commission on
the Transnational Corporation,
to serve as a clearing house for information on the subject
and to prepare a code of rights
and duties for host countries and transnational
corporations. Developed countries are mem
bers of the UN Commission on the Transnational Commission,
but are out-numbered, as is
true of most UN organizations, by the representatives of
developing countries. These latter
dominated the report of the Committee of Experts which proposed the Commission on the Transnational Corporation, and gave a developing country flavor to the report, emphasizing principally the rights of host countries and the duties of foreign corporations. Emphasis on the Permanent Sovereignty of Developing Countries over the natural resources within their boundaries—a right not in question—conveys a suggestion that nationalization need not entail “prompt, adequate, and effective” compensation as called for in the United States interpretation of international law, or that such compensation can be reduced by devices of taxes or fines for past “misconduct” levied retroactively. Multinational corporate activities in developing countries are inevitably an item on the North-South agenda in the years ahead. In the judgement of this observer, however, there is so little meeting of minds between North and South that it is useless to try to agree on a common code that would paper over the cracks but fail to yield operational guidance.

The OECD should continue to work on the problems of multinational firms among the developed countries, strengthening its code, giving it the teeth now said by the Economist to be lacking, leaving it open to adherence by countries of all levels of income and stages of development that want to accept it, but urging it on none. At the same time, developed countries should be wary about undertaking commitments in the UN Commission on the Transnational Corporation that mean something different to
the developing countries than
the evident language. Foreign direct investment in the
developing countries is shrinking,
and the reasons are evident: the present discounted value
of potential benefits is exceeded
by the value of the risk. I have elsewhere recommended that
the United States withdraw its
guarantees of, and insurance for, United States direct
investment abroad, on the ground that
they unnecessarily convert business into political
disputes. If United States firms are sophis
ticated enough to appraise the risks of foreign investment
as well as the government. Losses
abroad are already made good up to 48 percent, to the
extent that the investing firm has
profits on which it pays income taxes in the United States.
If developing countries do not
want foreign investment, there is no reason why the United
States or any other developed
country government should insist that they have it. On the
other hand, if they want it, there
is something to be said for the position that they must
create a climate in which developed
country business can operate with assurance. In this area,
in my judgement, little purpose
is served by the attempt to negotiate codes embracing North
and South, as contrasted with
rules of conduct for firms within the developed world, or
those regarding LDC treatment of
foreign firms, such as that reached in the Andes Pact. In
commodity problems, the OECD record is dominated by the
major failure in Novem
ber 1973 to take effective action in response to the Arab
OPEC embargo and the general
OPEC price hike, and to respond to the widespread fear echoing the reaction at the out
break of the Korean War in June 1950, that commodity prices would rise sharply again.

The failure was shared by the EEC and by the developed countries acting through normal
political channels. The increase in the price of oil was applauded by developing countries
as a victory for the class of countries, even though it affected many of them adversely,
and as a forerunner of further commodity price increases. The failure, of course, was to
ration scarce oil among the countries affected by the embargo, and especially to take care
of the needs of the Netherlands, which was subjected to an embargo of 100 percent, as
opposed to the 25 percent cut affecting other OECD members (except the United States,
an oil producer, the 100 percent embargo of which by Arab producers was not of critical
importance). The Netherlands energy position was alleviated, firstly, by its possession of North Sea
gas, that covered 40 percent of its energy requirements, and then by the reallocation by
international oil companies of Iranian supplies from normal customers to the Netherlands.

In this respect, private companies performed what may be regarded as a governmental
task, that is, sharing out scarce goods. This private discharge of a public task was required
because the OECD and EEC governments, allies of the Netherlands, were each setting
about to solve its energy problem in a national way, such
as by offering special inducements

for oil to Iran, rather than taking orderly joint steps to meet the crisis. Earlier, the United

States had placed an export embargo on soybeans, on which its ally Japan was dependent,

to issue the second Nixon shock to that country. Later Japan, exposed more than most of

the countries of OECD by reason of its dependence on imports of raw materials, went into

what appeared very close to panic, as it undertook to make special deals, not only for oil

but also for copper, iron ore, and other materials. The OECD inability to respond swiftly

to the crisis by the sharing of petroleum was only the last step in a series of failures in the

energy field since the earliest Marshall Plan days, the most serious of which doubtless was

the inability to agree on and finance, prior to 1973, a program of accumulating and storing

supplies of oil for an extended period. A ninety-day supply had been agreed but not widely

implemented. If it had been possible to accumulate supplies for a year, or perhaps only for

six months, as oil experts had recommended, the low vulnerability of Europe to the Arab

OPEC embargo and price hike might well have forestalled it.

North-South Relations within the OECD

The major North-South issue within the OECD of which I am aware is the problem created

for especially Turkey and Portugal by the actions of West Germany, France, and Switzerland

land in halting further immigration of workers from Mediterranean countries. The issue is
a complex one, with social and political as well as 
economic dimensions. Demographic 
conditions in Turkey especially, but also in Portugal, 
which has an additional employment 
problem posed by the return flow of its citizens from 
former possessions in Africa now 
independent, ensure that there will be serious unemployment 
in these countries stretching 
far into the future. These countries believe that this 
unemployment might be effectively 
alleviated, with benefits for national income, the balance 
of payments, savings, investment, 
and economic growth, if migrant workers could continue to 
go to OECD countries, but 
especially France, West Germany, and Switzerland to work, 
after recovery from the recession of 1975–6 has been accomplished. Greece, it should be 
noted, is not as interested in 
promoting worker emigration, as its own recovery has 
proceeded sufficiently far to make 
it anxious to retain its present work force, to attract 
back especially skilled workers in Northern Europe, and even to attract foreign workers 
itself. Yugoslavia has interests similar 
to those of Turkey and Portugal, but is not a full member 
of the OECD. Southern Italy is 
guaranteed free access to the labor markets of France and 
West Germany under the Rome Treaty of the EEC, but not to that of Switzerland. France, 
West Germany, and Switzerland 
restricted further immigration of workers in 1973 and 1974, 
ostensibly on the basis of a 
short-run decline in jobs, but more and more, as it appears, for social reasons, fearing
that they are unable to assimilate such workers in larger numbers. For humanitarian rea
sons, both France and West Germany are continuing to permit resident foreign workers to
remain, even though unemployed, in contrast with the expulsion practiced in the 1930s,
and to bring in dependent members of their families. They seem to be resolved, however, to
limit increases in the proportion of the labor force represented by Mediterranean workers,
even at a cost in economic growth and in inflation. OECD commitments calling for equity
of treatment of citizens of any country by other members may not be proof against the
intensity of concern in France, West Germany, and Switzerland over the problems created
by large numbers of difficult-to-assimilate foreigners. By the same token the fact of citi
zenship in the British Commonwealth was not sufficient to prevent a Labour government
of Britain from requiring Indians, Pakistani, and West Indians to have a job before migrat
ing, thereby effectively cutting off their immigration. To the economist, world welfare is
improved by moving labor from where it is cheap to where it can earn a higher return,
provided always that the Malthusian revolution has been accomplished in the country of
emigration and that the migrant is not immediately replaced by the natural increase of
population. But as in so many aspects of the world, the optimal economic and the optimal
social solution to the migration problem would diverge even
if the countries of emigra

tion had adopted effective family limitation, as most of
them have not. As the world gets

smaller, and information on differences in levels of living
is more widely disseminated, the

question of international migration threatens to transcend
the OECD context. It is already

important for Yugoslavs in Europe, and for Puerto Ricans
and Mexicans in the United

States. The Mexican/ United States instance demonstrates,
moreover, that legal barriers to

migration may not be effective. The New International
Economic Order

aid amounting to 0.7 percent of the gross national product
of developed countries, the link
to the SDR, new rules for the multinational corporation,
free use of the North’s technol
ogy, without restrictive business practices, plus
rescheduling of accumulated debts, more

stable exchange rates among developed countries, and a
share in any profits derived from

exploitation of the ocean seabed pose many problems for the
OECD countries at various

levels. Among them are whether these problems should be
treated in one great big pack

age deal, as called for by the developing countries in the
sixth and seventh special sessions

of the General Assembly of the UN and sought in the Paris
Conference on International

Economic Cooperation with its four commissions on
commodities, energy, finance, and
development; or one at a time, commodity by commodity
rather than eighteen commodi
ties at once, and rescheduling the debts of countries as required, along previous lines of the so-called Paris Club, rather than in one grand bankruptcy proceeding; whether the OECD countries should enter negotiations with the developing world with agreed positions, vote as a bloc, caucus on new propositions, or by and large take independent national positions and run the risk of being overcome through divisions; whether to seek generally market solutions to economic problems, or to embark on a system of world planning; whether to accept the proposition implicit in the New International Economic Order demands of the Group of 77, the Non-Aligned Group, the UK majority, and others, that a change in institutional arrangements will make possible significant increases in the levels of living of the Third World, as they admittedly did for the OPEC countries and for the coffee-growers outside of frost-stricken Brazil, without increases in productivity and output; whether in fact the need of the moment is not for less negotiation, less integration, fewer North-South agreements, and more for what is coming to be known as “decoupling.” In this writer’s judgement, to put the matter bluntly, the OECD and the developed world can make their greatest contribution to the development of currently LDCs by:

(1) Maintaining their own stability and growth, including relatively full employment, avoidance of inflation, and balance-of-payments equilibrium.

(2) Maintaining free markets, with readiness to accept LDC
imports and to adjust domestic resources to them. In the short run “market disruption” may require limited intervention. Over periods as long as five years the economic health of LDCs and DCs alike requires making room for emerging LDC exports of manufactures.

(3) Maintaining and expanding foreign aid through multilateral agencies.

(4) Abandoning governmental pressure to force LDCs to accept direct investment and encouragement to such investment through guarantees and insurance.

(5) Tolerating LDC attempts to raise prices of commodities along lines of the success of OPEC in oil, but neither endorsing them nor retaliating. It should be enough to remind developing countries of the lesson of economics that in the long run, equilibrium market-clearing prices must prevail, and that attempts to raise them higher will sooner or later fail, as the example of sugar in 1974 and 1975 so conclusively shows. This is a difficult and trying course of action for the developed countries, and especially

the sharing of the pain of making room for LDC exports of manufactures, of the deficit

that is the obverse of the OPEC balance-of-payments surplus, of the monetary and fiscal expansion needed to keep world income growing steadily, and of providing the aid. Such

burden-sharing is essential if the task of maintaining world stability is going to be accomplished. It is far more important than the difficult, probably impossible, task of negotiating

the demands of the New International Economic Order in an enormous package. This is not doctrinaire laissez-faire. The writer happens to believe that markets are generally right, but sometimes wrong, and that when they are wrong they should not be depended on. He believes that the private good of efficient resource allocation through well-functioning markets can be achieved only against the provision
of the public goods of macroeconomic stability, policing of markets against monopoly, and intervention as needed when from time to time, as happens, normally well-functioning markets break down. In times of acute shortage, scarce commodities must be allocated. In times of acute glut, redundant supplies should be taken off the market. Such provisions differ fundamentally from the view that the market is always wrong and needs to be supplanted by mechanisms of planning, allocation, and redistribution. When capital markets function poorly they should be supplemented by governmental aid, to assist redistribution as well as foreign resource flows, and by capital provided as a public good through the IBRD and IDA. One “public good” which the developed world seems to be unable to provide itself, but the absence of which is particularly painful to the LDCs, is international money, or what amounts to the same thing, the stability of exchange rates among leading currencies.

Developed countries have adopted floating rates because of inability to harmonize their own monetary, fiscal, price, and employment policies. The decision imposes a substantial burden on the LDCs which must decide, as each change in the relationship among major currencies takes place, whether to move with the dollar or the mark, the franc or the yen. It is sometimes suggested that each LDC should fix its money to a major currency, and abandon the direction of the external value of its money to it. Such advice fails to address the
reality that LDCs typically have a number of trading
partners, and resent subservience to

any. LDCs have a hard-enough task fixing the value of their
currencies to a stable DC net

work. When the DC currencies are themselves unstable, the
difficulties are compounded.

The needs of the LDCs in this regard are perhaps not
sufficient reason to alter DC policies

on floating. In the writer’s judgement, however, they
provide a further argument to already

compelling ones in behalf of international money. Finally,
there should be a lender of last resort to support
situations of financial break
down. For the LDCs, it should be the Paris Club. But the
LDCs themselves have a stake in

seeing that the DC financial system remains strong. The
OPEC countries seem finally to

have realized their vital interest in a flourishing world.
Within these limits of provision of the public
international goods of world stability, open

markets, and international money, and intervention to come
to the rescue in case of break
down, trade, commodities, and multinational corporations
should separately be permitted
to take care of themselves. This is not decoupling, as it
assumes continued North-South

interdependence. It may be attacked as “trickle-down” help,
though I would prefer to char
acterize it as emphasizing the key role of Japan, the
United States, and Western Europe

in world prosperity—necessary, but not sufficient, to
enable LDCs to grow of their own
efforts, with foreign aid. It does imply an attempt to
defuse issues of political economy
by letting markets work out continuously evolving solutions except where they are clearly incapable of doing so. The Big Package in which all international economic issues are rolled together into a tremendously complex and endlessly ramified agreement seems to appeal to diplomats and political scientists. It fails to attract this economist. There are examples of past successes, such as the Peace of Vienna in 1815. It seems dubious that this can be repeated in the economic sphere. I see nothing in theory, and little in practice beyond the incredibly difficult multinational negotiations under GATT, to suggest that eighteen commodity agreements can be concluded simultaneously when it is frequently impossible to conclude one. The OPEC embargo and price hike were strongly dysfunctional for the world, not only because they plunged the world into recession but because they spread throughout the developing world the illusion that instant wealth was a realistic prospect. In my judgement, the instant wealth of OPEC, like political independence for former colonial possessions, fails to solve the political and economic problems which these countries must overcome one at a time, and constitutes only a limited example of the path to be followed to develop. Like most poor individuals, most poor countries can reach affluence only by learning how to become productive. The prospect of striking it rich, winning a lottery, finding a pot of gold is delusive and subversive. Development is a slow, painful, frequently disheart
ening process, in which different countries move at different paces. Currently developed countries can help by foreign aid, by making room in international markets for newcomers as they learn to produce efficiently, and by opening the ranks of the OECD and other developed country groupings to those countries making the grade and wanting admission.

When individual countries are overwhelmed by debt, they should be forgiven in bankruptcy proceedings of the Paris Club type. The foremost task, however, and the one that eases every problem of the developing countries from commodity prices, balances of payments, debt service, to entry into new markets, is to maintain real income in the developed world growing. The most important work of the OECD in North-South economic relations is that of Working Party No. 3, and the economic summit planned for May 1977, among the developed countries themselves. Notes

1 John H. Williams, Postwar Currency Plans and Other Essays (New York: Knopf, 1944).


3 See, e.g., “India’s crucial plan,” The Economist, 25 February 1956, pp. 516-17: “In an undeveloped economy every thing has to be got going at once, so that the various sectors can provide each other with markets and complementary facilities; a lag in any one part destroys the balance of the plan.”


7 Hjalmar Schacht was especially bemused by such thoughts. See H.H.G. Schacht, “Germany’s colonial demands,” Foreign Affairs, vol. 15, no. 2 (January 1937) pp. 233–4.


10 It is of some interest that an American group under the editorial direction of William Yandell Elliott, proposed an “Atlantic” orientation of US foreign policy along OECD lines, with Japan included with Europe, Canada, and the United States as an honorary Atlantic power. See William Y. Elliott (ed.), The Political Economy of American Foreign Policy (New York: Holt, 1955).

Economic integration is perhaps not the most important topic that Fritz Machlup has dealt with in his long and illustrious career, but it has the distinction of being the most recent. As president of the International Economic Association, he gave an address on the “History of thought on economic integration,” at the Fourth World Congress of the Association held in Budapest in 1974. 1 That same year his Harms-Prize Lecture at Kiel was entitled “Integrationshemmende Integrationspolitik.” 2 Inevitably reminding us of the parable of Christ feeding the multitude with two fish and five small loaves, there was enough left over from these efforts, and especially the first, to fill a book, which appeared in 1976 and which testified to what we all know of his characteristic energy and drive to work. 3 Finally, though I use the word provisionally, he retraced a small piece of this ground in his paper given at the Nobel Symposium on Interregional and International Trade in Stockholm in June 1976, entitled “Conceptual and causal relationships in the theory of economic integration in the
As the informed reader will surmise, Machlup’s approach to economic integration, as to any subject he tackles, is multifaceted. He deals with the semantics of the subject. He has produced a far-ranging compendium of economic thought dealing with integration, covering four centuries and the literature in four languages. He, of course, subjects the topic to extensive economic analysis of his own. At an absolute disadvantage across the board, the law of comparative advantage induces me to neglect Machlup’s contributions to the history of thought on economic integration. To the extent that the semantics and the analysis can be disentangled, moreover, I choose to focus on the former. Machlup’s economic analysis of integration, as he himself indicates, amounts more or less to a textbook in international economics—an activity in which I may be forgiven for detecting diminishing returns. And semantics are, after all, close to the heart of Machlup’s contribution to economics. In Machlup’s view, the theory of economic integration is coextensive with the theory of interregional and international economics. Integration is division of labor—a neat oxymoron, since integration is oneness and division is two-or-more-ness. Its essence is taking advantage of all opportunities for efficient transfers of mobile factors of production, that is labor and capital, and all opportunities for efficient division of labor, using “labor” in the Ricardian sense of all productive factors. On this definition, economic integration is underdetermined, since as Robert Mundell has shown, under
certain specified conditions

factor transfers can substitute for trade or trade can substitute for factor movements. 5 For the most part, Machlup's analysis deals with trade, rather than with factor movements. It would be possible to insist on, first, all factor movements that are possible, and then trade to the extent of the remaining room for equalizing goods prices, on the assumption that factor movements would in the real world fail to achieve equalization of goods prices. But the fact that Machlup insists on the division of labor as the essence of integration indicates his concentration on trade. Factor movements substituting for trade constitute a division of labor only in a limited geographical sense, and not in the sense of specialization and exchange the expression normally implies. Trade substituting for factor movements, or factor transfers substituting for trade, seems to imply factor-price equalization, and this has been suggested in the literature as a criterion of complete economic integration. 6 Machlup, however, rejects this measure, largely on the practical ground that it is difficult, perhaps impossible, to take adequate account of differences in quality of land, labor, and capital between countries in comparing factor prices, or of differences in risks, actual or perceived, in discounting yields on securities to measure the return to financial capital. This fastidiousness seems excessive, especially in the light of the liberties with data that the present generation of econometricians is forced to take.
and does take, on the whole, cheerfully. There are, to be sure, some questions that must be raised when factor-price equalization is chosen as the criterion for economic integration,

but there are also some serious theoretical losses that result when it is rejected. Factor-price equalization can be achieved by trade—under highly restrictive conditions which every graduate student learns to rattle off—linear homogeneous production functions of degree one, perfect competition in goods and factor markets, no transport costs, no factor reversals, more goods than factors, no complete specialization, and so on, and so on.

It can also be achieved by factor movements. But there is a third possibility which involves neither trade nor factor movements. If skewness of resources is exactly offset by skewness of demand, goods prices may be equalized, and with the appropriate assumptions from the foregoing list, factor prices as well. This is surely not integration, and there is no division of labor, except in the trivial sense that each country specializes in minding its own business. There is a fourth possibility. It involves no trade, and no movement of indigenous factors. Factor prices can be equalized between two countries in a multicountry world with movements at the margin of outside factors. Because such movements are marginal, they can be limited in size. In the Europe of the 1950s and 1960s, substantial progress toward factor-price equalization was achieved through the movement of American corporations, Euromoney and Eurocapital, and Mediterranean labor. Assume
that German and French
corporations are unwilling to establish subsidiaries in the
other country, that German and
French capital do not move from one country to the other,
and that German and French
accord somewhat loosely perhaps to the facts. If American
corporations are prepared to
move enterprise between Germany and France so as to
equalize profits, if German and
French capital move rather freely back and forth to the
Euromoney and capital market, and
if Mediterranean labor is ready to shift between Germany
and France in search of higher
wages, factor-price equalization can be achieved—or at
least approached—without either
trade or movement of French or German productive factors,
and there is no integration.

Things equal to the same things are equal to each other,
but may remain at base separate
and disintegrated. The division of labor is performed by
outside factors, on a geographical
shifting basis, and not through specialization and
exchange. Factor-price equalization is therefore an
adequate criterion for economic integration
when it is accompanied by oneness, that is, the unification
of markets, for goods or factors.

And when there is oneness or unification of markets,
factor-price equalization has a gener
ality as a criterion for economic integration which is
unhappily lost in Machlup’s rejection
of it on operational grounds. Take a labor market. If
blacks and whites are paid different
wages, the labor market is surely not integrated. As wages
for whites and blacks of the
same skills, experience, credentials, or performance converge—the multiplicity of criteria underline the validity of Machlup's diffidence—the labor market may be said to be more integrated; as they diverge, less so. Women are integrated into the general labor market to the extent that they receive the same pay for the same work as men. Machlup's claim that the criterion is nonoperational has overtones of perfectionism. At the inter-regional or intra-regional level, it is being used operationally, if not by economists at least by lawyers and judges in legal actions, every day. It is true that factor-price equalization as a sole criterion of economic integration diverts attention from oneness, and oneness is the essence of integration. Given oneness, however, factor-price equalization is helpful in establishing a base of complete integration toward, and away from, which markets and economies may move. It has operational difficulties, but the same is basically true of all economic aggregates. More or less oneness conveys a sense of paradox, and here Machlup misses a chance of semantic exploration—what others may choose to call hair-splitting. It is one, moreover, which has relevance to international economic policy, and particularly to the differences between British and United States views on tariff discrimination and customs union. The debate goes back to the discussions of the draft charter of the abortive International Trade Organization at Geneva and Havana in 1947 and 1948. The United States insisted that the
exception to the rule of nondiscrimination for customs unions and free trade areas must be all or nothing, go or no-go, yes or no, like pregnancy, rather than divisible by degrees.

British negotiators maintained that it was illogical to insist that 100 percent discrimination in favor of a trade partner in a customs union or free trade area was acceptable, whereas 99 percent was not. The American arguments that I recall from the period were admittedly unconvincing. It was feared that if a country started to discriminate less than totally with a trade partner, it might find itself sliding down a slippery slope of discriminating widely.

Anything less than 100 percent discrimination was thought to be a positive feedback process, or habit forming, like eating peanuts. But some actions are habit forming; others are not. There is no evidence that I am aware of which would support the view that to discriminate 99 percent in favor of a country would start a country down the road to wicked trade practices. It is true, however, that some relationships are divisible and others are integral. In undergraduate classes, I cite friendship as a relationship that can be measured by degrees, and marriage as one that is indivisible (of late this analogy has seemed less apposite). And occasionally, it has helped beginning students to fix the idea in mind when I recall a song of Sophie Tucker from the 1920s: You gotta see Mama every night Or you can’t see Mama at all. You gotta see Mama and treat her right, Or she won’t be there when you call.
And then the verse becomes quantitative: If you want my company, You can't fifty-fifty me. You gotta see Mama every night, Or you can't see Mama at all. Oneness is of course oneness of markets. Adding one and one makes not two, but, with

perfect integration, one. If we allow for degrees of integration, with more or less, rather

than only integration-nonintegration as in the customs union issue above, one and one may

make one and a half. The law of one price states that in one market there is one price. As

we have seen in early examples of curiosa-cases of factor-price equalization without

oneness—there may be one price and separated markets. But there is an intermediate posi

tion: one price and markets which are neither merged, nor completely separate, markets,

that is, which are joined. This is integration in the Machlup sense of division of labor. It is,

however, both a semantic and an analytical question whether joined markets are as truly

integrated as merged or added markets. The point may be illustrated by an example I have discussed on an earlier occasion. 7

The San Francisco and New York capital markets can be joined in two different ways: one,

by taking the excess demand for savings in San Francisco and transferring it to New York

until rates of return are identical (or more realistically, diverge by some customary wedge);

the other, by shifting San Francisco demanders and suppliers of savings both to New York

and merging them with New York demanders and suppliers of savings available for use in

California to arrive at a common demand curve, a common
supply curve, and, of course,
a common price and quantity. The first is the method used
in trade, balancing off excess
demand in one market against excess supply in the other
until prices are equated. The sec
ond, which is a possibility only when transport costs are
negligible, implies merger of mar
kets rather than division of labor. In each case there is
but one price, but the prices will be
different. A California bond issue sold in New York to
Californians and New Yorkers differs
in mind from the same volumes of savings sold in two bond
issues, one marketed in San
Francisco and the other in New York. California savers are
willing to accept a lower coupon
rate on a bond issued in New York because of the increased
liquidity inherent in such an
issue, which will be traded in a much wider secondary
market than that in San Francisco.

Commodities may not be altered when separate markets are
joined by trade, through equat
ing the excess demand in one with the excess supply in
another at a single price adjusted
for transport costs. In today’s world we do not add demand
and supply curves in two or
more countries to form single demand and supply curves. Someth
ing like this occurred
in the seventeenth, eighteenth and nineteenth centuries
when colonial goods were stapled
first through Amsterdam and then through London. It may
even be that the goods were
improved in the stapling emporia through quality control,
repacking and the like, and hence
differed from goods directly traded, although the historical sequence from stapling to direct trade makes this unlikely. There may be an analogous phenomenon in labor migration, but it eludes me, unless one makes a distinction between a labor excess supply in one country that meets an excess demand in another and equalizes wage rates on a temporary basis that will later be reversed, and permanent migration where the immigrants are assimilated into the labor force. Leaving aside the cases of commodities and labor, however, we can say of capital that oneness of price is compatible with two means of joining markets. And it would appear that a higher form of integration is achieved when the demand and supply curves in the two markets are added together, rather the excess supply in one country being matched against excess demand in the other. Oneness of markets can be frustrated by more than governmental barriers, and within the category of barriers by more than merely tariffs, barriers to migration, and capital taxation or controls. Governments discriminate, but so do Nature and people. Governmental discrimination, moreover, derives not only from tariffs, but from non-tariff barriers (NTBs) such as taxation, state regulation, as in pure food and drug laws, pollution control, parochial standards of weights, measures, labelling, and the like. Machlup, of course, is fully aware of the necessity for integration to go beyond tariff elimination and to harmonize taxation, governmental benefits, and regulation of all kinds to achieve integration in goods markets.
He is not equally disposed to take into account the separation of markets by discrimination on the part of Nature and of individuals. For discrimination by Nature, let us consider an intellectual experiment of an attempt at integration between New Zealand and old Zealand, or, if you like, the country of Denmark rather than its most prominent province. Governments, let us assume, put aside their rivalry in the British butter market and prepare a customs union between the two countries, harmonize direct and indirect taxation, governmental benefits, regulations of all sorts.

Assume that New Zealanders and the Danes are prepared to merge fully, but let us leave aside for the moment actual migration. Would this be integration? The two countries would make “actual utilization of all potential opportunities of productive resources and efficient division of labor” (Machlup’s italics, my brackets to eliminate indeterminacy), but the result would hardly be oneness. Nature has put the two countries in separate hemispheres, both longitudinally and latitudinally. Transport costs must overwhelm all but a very few potential opportunities for division of labor, and if these are all completely used, the degree of integration would be low. Discrimination by people—whether as consumers or as producers—raises a further semantic-analytical question. Let us assume two countries that happen to be contiguous so that transport costs are low, with skewed resources, skewed tastes which offset the skew
ness of resources, identical goods prices, and factor-price
equalization because of the presence of the conditions posed by the assumptions of the factor-price equalization theorem.

There is no division of labor. Is there potential for division of labor? It depends on whether

tastes are exogenous or endogenous, whether we allow for demonstration effect, and the

harmonization of tastes from frequent intercourse between the people of the two economies, or not. If people discriminate by tastes and demands, the potential opportunity for
division of labor can quickly be exhausted without economic integration in a commonsense view of that term, that is, oneness of the economy. Integration does not require identical

homothetic demand maps, any more than does the factor-price equalization theorem. It

is enough that tastes are less skewed than resources in the portion of the map relevant for

the before-trade after-trade comparison. But the more nearly identical are tastes, and the

more skewed resources, the larger the opportunities for efficient division of labor, and for

integration. People may discriminate as consumers, but also as producers. On previous occasions I

have referred to the fact that when the sovereigns of Belgium and the Netherlands cut the

ribbons along their mutual border to signalize the readiness of the Belgium-Netherlands Luxemburg (Benelux) governments to permit the movement of labor among the members,

nothing happened. The Dutch stayed on their side of the
frontier and the Belgians on theirs

despite differences in wages that might have been expected
to lead to equalizing move
ments of labor. Cultural and political discrimination led
to economic discrimination and

prevented “efficient transfers of productive resources,” if
we define “efficient” in terms
of Pareto-optimality without allowing for differences in
the tastes of producers. It is pos
sible to regard this as a second-best solution, one in
which competition is less than perfect

because producers discriminate, or in which nationalism is
an argument in the objective
function, along with economic well-being. “Potentiality”
may be constrained by tastes or it

may not be. If it is so constrained, one will have to
conclude that all potential opportunities

for efficient transfers of resources are actually utilized,
but that few exist because of differ
ences in tastes or the existence of nationalism. If we
assume that the potential opportunities

for efficient division of labor are limited for any
reason—because of separation by Nature,

separation by transport costs such as might arise from
strong demands for services that are
produced and consumed locally and not traded
internationally, or separation by differences

in tastes for goods, or strong attachment to the home
country which makes migration intol
erable, we shall have to conclude that Machlup’s criterion
for actual utilization of potential

opportunities for efficient transfers or efficient division
of labor can be met without achiev
ing much in the way of oneness, which is the essence of economic integration. Applying these notions to the European labor market throws light on what Machlup may mean by “potential.” In 1973 and 1974, Switzerland, France, and Germany halted the immigration of further foreign labor. The evidence makes clear that the reasons for so doing were largely social, despite some protestation on the part of West Germany that the move was dictated by the business cycle. The Swiss were worried about what they regarded as the threat to their national identity, or Swissness, as the proportion of the labor force represented by migrants reached one-third. Germany, with a lower proportion—close to 10 percent—nonetheless felt itself unable to assimilate 2,400,000 workers and their families, most of whom had no interest in learning the language or identifying with the German culture. Halting the immigration may be taken over the longer run to be inefficient, though the cost in the short run is zero or even a gain. The economics of the move to be sure are some what debatable. But there can be no doubt that halting immigration is an act of economic and social disintegration between Central and Northern Europe, on the one hand, and the Mediterranean and Eastern Europe on the other. The social potential for oneness is low; the economic potential larger. There rests an important question, however, whether such an economic potential may be said actually to exist when the social potential is so limited. Thus far the argument has been conducted in static terms treating countries as units
rather than aggregates. Machlup, of course, recognizes the dynamic aspects of the process of integration, and particularly the scale economies and decreasing costs, with which Sci tovsky’s name is associated. He also approaches disaggregation of national economies in recognizing backwash effects, emphasized by Myrdal. Freedom for factor movements may drain the cheap-labor countries of their best workers, and capital, so that the rich country gets richer and the poor poorer. This effect of complementarity among disaggregated units of an economy is noted, but it raises an interesting problem which even the rich and full contribution of Machlup does not fully explore. Integration and disintegration can exist side by side. Take two economies which are themselves integral, but made up of closely related sectors, regions, industries, or other subsidiary parts. The theory of integration normally sums countries as integers, adding one and one to make one as in $X+Y=Z$. But if $X$ and $Y$ are aggregates, rather than simple units, the process of addition may be more complex. In his book on the Crédit Lyonnais, Jean Bouvier notes that the bank held its breath, so to speak, as a new railroad joined a particular town more intimately to the rest of France, waiting to see whether the new connection would create new opportunities for growth and profitable banking in the town, or kill existing opportunities. One unhappy village near Dijon was punished twice, first by the north-south railroad which brought in the better
wines of Burgundy to destroy its viticulture, and secondly by an east-west railroad which
introduced cheap, excellent beer from Alsace and ruined its attempt to build a brewing industry as a replacement for wine. Highly localized, idiosyncratic regions like western and southwestern France, southern Italy, eastern Bavaria, and peripheral Scotland, Northern Ireland, and Wales may be cut off and in effect abandoned by the efforts of the country to integrate with foreign countries; which stimulates mostly the portions of the country adjacent to the new partners. At an early stage in mercantilism, national integration was provided by improved transport, removed internal barriers to trade, and movement of labor and capital, by the public goods of uniform justice, a single national money and capital markets, and the like. The countries we think of as ripe for international economic integration were themselves thoroughly disintegrated in the Middle Ages. 9 International integration today has the effect of undoing some considerable part of the earlier national integration. If one regards countries not as units but as decomposable matrices, a question arises whether it is integration, disintegration, or both to unify certain of the mobile, transformable, or dynamic parts of the economy in one country with similar subunits abroad, whilst leaving other subunits in both countries to revert to their premercantilistic separate condition. Contemplate two couples, each with children. Is it integration,
disintegration, or both if the handsome and rich husband in one couple runs off with the beautiful wife in the other, each leaving behind an average spouse and dependent children whom I hesitate to characterize. In the European case, of course, the Social Fund and the Investment Fund were established to look after the portions of the countries adhering to the Treaty of Rome which might suffer from backwash effects—a sort of alimony in the extension of our elaborate metaphor of friendship, marriage, and separation. It is nonetheless less well to remember that while integration is the addition of one and one to make one 

\[(X+Y=Z), \text{ when } X \text{ and } Y \text{ are decomposable matrices, the result may be } X+Y=Z+x+y, \text{ and it is better to analyze the case rather than to characterize it as integration, disintegration, or both. The problem with economic integration arises from the fact that the word itself has positive overtones, or resonance. Just as there are persuasive definitions, so are there “buzz words,” which need merely to be spoken or written to evoke an affirmative response. We all intuitively applaud weddings, deprecate separations and divorces. As the world becomes more complex, an increasing number of cases involve the two simultaneously. Is integration good? The United States has always thought so. That bigger is better is a typical American view of life. The preamble to the European Recovery Act of 1948—acting the Marshall Plan into law, and written by the Congress rather than by the Executive Branch of the government—urged a United States of Europe so
that the Continent could enjoy the benefits of a wide market like that in the United States. Paul G. Hoffman’s speech of 31 October 1949 echoed that same theme. Most of us intuitively feel a sense of loss as we contemplate separatism in Quebec, devolution in Scotland and Wales, independence movements in Brittany, the Basque country, and Catalonia. So deeply felt are these sentiments that civil wars have proved to be among the most devastating in history. These attitudes are not without challenge today. E. F. Schumacher has made many converts with the notion that smaller is better. A number of pundits interested in economic development are studying “decoupling” of North and South as these terms are applied world-wide, with the thought that interdependence is fraught with political tension and potential strife; to reduce the division of labor internationally, leading to less dependence, is regarded as conducive to peace. Johann Galtung, the Norwegian sociologist, equates dependence with exploitation, and even interdependence with mutual exploitation—a suggestion I found fanciful until Martin Bronfenbrenner pointed out that husband and wife can mutually exploit one another if he regards her as a servant and she him as a meal ticket. I refuse to believe that all marriages are like that. Machlup’s escape from this dilemma is a sound one, through the distinctions between Pareto-optimality and welfare economics, on the one hand, and between private and public goods on the other. The efficiency criteria of
Pareto-optimality are irrelevant as a guide to policy in a world of interdependent welfare functions, where distributional criteria are paramount and one country is made worse off by the gains of another, even when its own real income does not decrease and may even increase. Integration that makes both parts of the new whole richer may be intolerable if it widens the gap between them absolutely, even if the rate of gain in the poorer country is higher than that of the richer. For private goods, Machlup hypothesizes, the optimum area is the world, whereas the optimum cultural, social, and political area appropriate for public goods may be much smaller. (I would take exception to this for economic public goods, like money, where I cling to the minority opinion that the optimum currency area is the world.) For private goods, bigger is better, and integration or the division of labor has a positive value, optimally on a world basis, with perhaps half-way stops at customs union or free trade areas. The public goods of nationalism, cultural identity, local participation, and the like flourish only on a smaller scale, with an optimal area, in a number of cases, smaller than present countries if the separatist movements are to be taken seriously, as presumably they should be. In the clash between economics and the other social sciences, which is likely to prevail in determining the scale of activities? Machlup, like Marx and like most economists, including the writer, seems to think that in the long run economic considerations will domi
nate, and lead to integration on a wider and wider basis until it encompasses the world. But if economic integration is a potential good, and political integration a possible bad,

perhaps it is time to stop using the word “integration” with its multifarious overtones,

semantic and otherwise, and to stay closer to the analysis. This is a lesson which Machlup has often preached to the rest of us. Notes


2 Published Kiel, Institut für Weltwirtschaft, 1974.


9 See Fernand Braudel, The Mediterranean and the Mediterranean World in the Age of Philip II (New York: Harper & Row, 1972; Torchbooks, 1975), vol. 1, pp. 384-5: “European countries were checkered by low-cost regions which were in every case separate worlds by-passed by the general economy… What more backward and uncomfortable province could there be than Brittany? … There were similar
regions in England.”

It happens that I had my say on the origins of the Marshall Plan almost thirty-four years ago, and have little to add. In that paper, I noted the contributions of the press, notably Walter Lippmann and James Reston, of Department of State officials at the highest level, such as Dean Acheson, William L. Clayton and George Kennan, and speech writers such as Joseph Jones. (It seems to go relatively unnoticed in international politics that the necessity to say something interesting in a speech promotes innovations in policy; in addition to Jones’s authorship of Acheson’s Delta, Mississippi speech, the other shining example is President Truman’s Point IV program, written by Ben Hardy of the Department of State’s writers’ stable in response to President Truman’s request for a speech which would be positive, take some of the negativism off the Truman Greek-Turkish doctrine of February 1947, and offer a Truman challenge to the positive resonance of Secretary Marshall’s speech of 5 June 1947.) Since Harold van Buren Cleveland, Ben Moore and I have been mentioned a few times.
for a memorandum on the need for a reconstruction program for Europe as a whole—a low-level Department of State effort under way in the economic side of the Department, with no encouragement or support from the lower political regions—it may be helpful to historians if I say something on the issue. Cleveland and Moore worked in the trade side of the Department under Clair Wilcox. I was engaged on German Economic Affairs in a division on occupied areas. The initiative in the matter came from Cleveland and Moore, probably the former as I vaguely recall it. They came to our division to ask if we would furnish a passage on how Germany fits into the reconstruction of Europe. For the most part our staff was deeply engaged in pressing emergency questions of reparations, acquiring sufficient foodstuffs, exporting coal, and the like. I vividly recall an argument between Van Cleveland and George Jacobs on my staff in which Cleveland in exasperation said “The trouble with you, Jacobs, is that you have tunnel vision,” to which Jacobs replied “The trouble with you Cleveland is that you are wall-eyed.” [See p. 107 above.] Despite the differences in focus, our division added a number of pages to achieve for me footnote immortality. 2 The roots of this positive attitude go considerably further back, of course. As early as 3 July 1945, the Department of State under Edward S.Mason as Assistant Secretary for Economic Affairs, aided by Walt W.Rostow, pressed hard for the revival of German coal production for export to liberated territories, and of
German machinery production
for coal mining, to help reconstruct the Polish industry in
Silesia. In the fall of 1945 we
reinterpreted the Potsdam agreement on reparations to deny
the Morgenthau Plan, stating
that we wished to have removals of capital equipment to be
sharp and quick, following
which rebuilding could take place to enable Germany to
contribute to the reconstruction of
Europe and its own economy. The more interesting initiative
occurred in the spring of 1946, and heightened a split
between economists and political officers. The episode
which led to the creation of the Eco
nomic Commission for Europe is described in detail with
much supporting documentary
material in a book by Walt Rostow. 3 The cold war was
hotting up and the political officers
were more ready to accept it than were we. Men like
H. Freeman Matthews, Elbridge Dur
brow, and James W. Riddleberger were cynical and tired from
years of negotiating with the
Russians in the European Advisory Commission (EAC) in
London. They felt that Russian
acceptance of any general principle was suspect in that it
would commit the United States
but not the Soviet Union, which responded only to
tit-for-tat bargaining, as for example let
ning an American ship out of Murmansk in exchange for our
allowing a Soviet ice-breaker
to make passage through the Panama Canal. For their part,
the economists following the
initiative of Rostow, who was a member of the Division of
German and Austrian Economic
Affairs, were anxious to tidy up the sprawl of agencies concerned with the recovery of Europe—the European Coal Organization, the Emergency Committee for Inland Transport

Organization (as I recall it: the initials were certainly ECITO), and the Emergency Economic Committee for Europe (EECE). We drafted a number of communications proposing a new European-wide organization to tackle European reconstruction problems more systematically, and with the help of Clayton and E.G. Collado, persuaded the Undersecretary, Mr Acheson, to get the Secretary to put it forward to the May-June meeting of the Council of Foreign Ministers (of Britain, France, the Soviet Union, and the United States). I remain vague on the steps by which this finally emerged as the Economic Commission for Europe, which met in Geneva for the first time in April 1947. It was on his way back from this organizational meeting that Mr Clayton became thoroughly discouraged over the collapse of the European economic fabric, with city and countryside no longer trading effectively with one another because monetary conditions were chaotic, food desperately short at the end of the disastrous 1946–7 harvest, and industrial production set back by the hard winter. 4

Back in Washington the trade and commodity side of the Department, as contrasted with the political divisions and my own German and Austrian economic affairs group, had been busy drafting papers in the State-War-Navy Coordinating Committee calling for systematic
reconstruction efforts worldwide, but with emphasis on Europe and food, coal, fertilizer, steel, and capital equipment. 5 Paul Nitze, Robert Schaetzel, Joseph Coppock, William Phil lips, and especially Harold van Buren Cleveland and Ben Moore were involved at some point in the period from March to July 1947, with a committee set up in June, shortly after the speech, under the chairmanship of Willard Thorp. My conclusions on the origins of the Marshall Plan are that it emerged largely from the economic side of the Department, with causa remota being the German and Austrian economic division, an intermediate cause (my Latin fails me) being the economists in the trade and commodities divisions, and the causa proxima being the Undersecretary, Mr Clayton, and George Kennan, the chief of the Policy Planning Staff, virtually the only political officer to take a leading role. The conventional revisionist wisdom produces a number of views which seem to me true, if at all, only in some subconscious psychological sense. Gimbel’s book, for example, rejects the major interpretations in favor of an argument that French intransigence about reparations and the allocations of food and fuel were the chief obstacles to four-power control of Germany, with the Marshall Plan put forward to ensure German economic recovery and to make it politically acceptable to Europe and the United States. 6 The argument is unpersuasive, and fails to conform to any recollection of mine. At the Moscow Conference
of Foreign Ministers (CFM), the French were not taken seriously, given the fact that the Foreign Minister was frequently incapacitated by alcohol. Another revisionist view is that the offer to the Soviet Union to participate in the recovery program was insincere, because it was known in advance that that country would not. Again I have a hard time understanding how they knew since at the time everyone with whom I communicated in the Department—a skewed low-level economic set to be sure—had a different view. We were pleased when Poland and Czechoslovakia accepted the Marshall invitations, concerned when the Soviet Union sent Molotov to Paris, relieved when he withdrew because we envisaged that the Russian bear could choke the program to death by embracing it. Perhaps our betters knew. We did not. I remain sceptical of the view that the offer was not genuine. At this stage I run out of material on the origins of the Marshall Plan, but I cannot resist making a point by way of recantation on the economic analysis of the program to be discussed by Lincoln Gordon and Van Cleveland tomorrow. The issue turns on what econometricians call an identification problem, or what is sometimes vulgarly known as a chicken-and-egg problem. In making and defining the estimates of the amounts of assistance needed for Europe, we economists claimed to have calculated the balance-of-payments deficits of Europe and financed them. Somewhat later, Fritz Machlup made a sharp point that the financing made possible the deficit, which
could not have been allowed to
develop had the funds not been there, as contrasted with
our claim that the finance was
needed because of the deficit. 8 I felt uneasy at the
time, and somewhat later I confessed to
the professional sin of having used an economic model that
I knew to be doubtful. 9 Thirty
four years of subconscious and a month or so of conscious
reflection now lead me to defend
the departmental position of 1947-8. The issue is one that
reaches deep into the heart of
economic analysis of real situations and turns on whether
the economist allows his models,
worked out for understanding of long-run equilibria, to
serve in policy issues. The Heckscher-Ohlin-Samuelson
(H-O-S) model of international trade says that com
parative advantage conforms to underlying factor
proportions. What a country exports and
imports will depend upon, first, its factor endowments and,
second, the empirical fact that
some commodities are normally produced in labor-intensive,
some in capital-intensive, and
others in land-intensive ways. The relevance of this to the
Marshall Plan is that the war alters factor proportions.
Take
Germany as an example. There was substantial capital
destruction and an increase in popu
lation on a smaller territory, because of the return of the
Volksdeutsch from Eastern Europe,
the refugees from territory ceded to Poland, and the
Flüchtlingen that poured into West
Germany from the Soviet zone of occupation. The H-O-S
theorem, if it were used for
short-run analysis, would call for a new set of exports and
imports for Germany, with labor-intensive exports such as textiles, shoes, and the like, and capital and land-intensive imports. One highly reputable economic journalist, of German background, Kurt Bloch of Fortune, talked as though this were the obvious thing to do (although I lack a reference to the view in writing). 10 There were, however, a number of distinguished economists and politicians who used the same implicit model of a highly malleable European economy that could transform its resources from one to another industry. Senator Joseph Ball said on the floor of the Senate in the spring of 1948 that there was no need for the Marshall Plan. All that needed to be done in Europe was to balance national budgets and to depreciate the exchange rate to the purchasing-power parity level. A more general statement was put forward by Gottfried Haberler of Harvard: halt the inflation and adjust the exchange rate. 11 Similar positions were held by Friederic Lutz, Henry Hazlitt, and somewhat less rigidly by Jacob Viner and Fritz Machlup. Some years later in talking with Jan Tinbergen of the Netherlands, and thoroughly imbued with the H-O-S model, I asked him why in planning the recovery of the Netherlands, he had not taken into account the Dutch loss of capital and gain in population (from the halt in migration and the pullback from the Netherlands East Indies) and planned for labor-intensive exports. He said he had not thought of it. The instinct of some economists
is a superior guide to policy than the ratiocination of others. Economic structures are malleable with time within limits, but there is a heavy burden of hysteresis or inertia that makes it much easier to restore the status quo ante, to shape the factor proportions to the structure of international trade, rather than the reverse. The issue is general, and especially divides the Chicago School of today from the rest of us. Let me in conclusion deal a low grade to a Keynesian point of view, closely connected with the Marshall Plan as applied to Italy. The first use of Keynesian analysis in a major governmental document that I recall is that of the Harriman Report, largely drafted by Richard Bissell. It was a brilliant use of the links running from investment to national income, both for short-run business cycle analysis and for growth. By 1948 most economists in government were Keynesians, and a group of them in the European Recovery Program office in Rome undertook to lecture the Italian government on the necessity for running a deficit to correct the substantial unemployment. Luigi Einaudi, then Finance Minister and later President of the Republic, refused to accept the analysis, maintaining that the unemployment was structural, from wrong factor proportions, not cyclical from a lack of effective demand. 12 Gordon and Cleveland tomorrow will doubtless claim that the economic analysis that went into the Marshall Plan was exemplary. After having claimed so much for economists as contrasted with foreign service
officers for the origins of the

Marshall Plan, it seems to me well to inject a suspicion of
humility. One should also observe that the immediacy of
the success of the Marshall Plan was in

considerable part owing to the fact that the disastrous
harvest of 1946-7 was to make eco

nomic analysis and planning appear a great deal more
effective than they actually were. Notes

1 Charles P. Kindleberger, “Memorandum for the files:
 origins of the Marshall Plan,” in US Department of State,
Foreign Relations of the United States, 1947 (FRUS), Vol.
reprinted as Chapter 2 in the present volume.

2 See, for example, Joseph M. Jones, The Fifteen Weeks
p. 241; and Max Beloff, European Unity and the United
States (Washington, DC: The Brookings Institution, 1963),

3 W.W. Rostow, The Division of Europe after World War II:
p. 73-5: “to some limited degree, impossible to measure,
the formulation and circulation a year earlier of a
recovery plan linking a European organization to enlarged
American aid, plus the midwifery of bringing it to life,
may have contributed an element to the creative ferment
that yielded the Marshall Plan as something that had to be
done.”

4 See memorandum by W.L. Clayton, ‘The European crisis,” 27

5 See Report of the Special ‘Ad Hoc’ Committee of the
State-War-Navy Coordinating Committee, 21 April 1947, in

6 John Gimbel, The Origins of the Marshall Plan (Stanford,

war,” International Journal (Canada), vol. 23, no. 3
(summer 1968), pp. 369-82. Now reprinted as Chapter 6 in
the present volume.


Jensen, Bartell C. (1966), The Impact of Reparations on the Post-War Finnish Economy: An Input-Output Study, Krammert Graduate School Purdue University Monograph Series (Homewood, Ill.: Irwin).


Kiljunen, Kimmo (1985a), Industrialization in Developing Countries and Consequent Trade-Related Restructuring Constraints in Finland (Helsinki: Labour Institute for Economic Research).

Kiljunen, Kimmo, Regional and Country Studies Branch, Division of Industrial Studies, United Nations Industrial Development Organization (1985b), Finland in the Changing International Division of Labour (UNIDO, 6 September).


Oksanen, Heikki, and Pihkala, Erkki (1975), Suomen Ulkomaankauppa, 1917-1949 (Finland’s Foreign Trade) (Helsinki: Bank of Finland).

Olson, Mancur, Jr (1982), The Rise and Decline of Nations (New Haven, Conn.: Yale University Press).

Pihkala, Erkki (n.d., c. 1969), Suomen Ulkomaankauppa, 1860-1917 (Finland’s Foreign Trade, 1860-1917) (Helsinki:
Bank of Finland).

Pihkala, Erkki (1986), “War consumption and war financing in Finland in World War II,” paper submitted to the Ninth International Congress on Economic History, Berne, Switzerland, August, session on The Economics of World War II.


Senghaas, Dieter (1985), The European Experience (Dover, NH: Berg).


Suuriranta, Br. (1947), “Finland’s war indemnity,” Svenska Handelsbanken INDEX (March), pp. 3-44.


Wuurinen, John H. (ed.) (1948), Finland and World War II, 1939-1944, a manuscript by an anonymous author or authors from 1946 or earlier (New York: Ronald Press).

13 1987 Belgium after World War II: An Experiment in Supply-side Economics


Federal Reserve Bulletin, various issues.

Gillingham, John (1977), Belgian Business in the Nazi New Order (Ghent: Jan Dhondt Foundation).


Ministère des affaires économiques et des classes moyennes, Service des études et de la documentation générale (1948), L’Economic belge en 1947 (Brussels: Pavrey).


Stuart, James Montgomery (1876), The History of Free Trade in Tuscany, with Remarks on Its Progress in the Rest of Italy (London: Cassell, Potter & Galpin).


Did Dollars Save the World?


The white-haired among us will recognize the title of this paper as a variant on that of a book written forty years ago by Henry Hazlitt, Will Dollars Save the World? (1947). His answer was that they would not, and today that is the answer of some revisionists such as Alan Milward (1984) and Harold van Buren Cleveland (1984) who thought he was saving the world in 1946-8 in the Department of State, and thereafter in the Economic Cooperation Administration, but who has since been converted to a monetarist faith and ruefully now concludes that the Marshall Plan was not necessary. I think that Marshall Plan dollars did save the world, and propose to demonstrate this, pointing out, first, what, if anything, “saving the world” means and, second, examining and criticizing the counterfactuals of those who felt either that there was no need to save it or, given the need, it could have been saved in dollarless fashion. I assume in all this that the world today is safe, whether it was
or not in 1947. But first let me ask: “Did Bob Tufts save
the world?” I am less an economic historian than an
historical economist, an economist, that is,

who plays with historical material dug up by real
historians. For this occasion, however, I

spent a few hours in the National Archives in Washington,
searching for Bob’s footprints

on the Marshall Plan scene, and found many. The first is a
record of a meeting of 29 April

1947 on “Work assignments for July 1 report of Functional
Economic Committee,” drafted

by H.van B.Cleveland, the report intended to determine “the
differential impact on the

United States economy of a more extensive aid program”—this
a month before the Mar
shall speech at Harvard. In attendance among nine others
was CP-Tufts. (“CP” in this

connection stood for Division of Commercial Policy, not
Communist Party or Command

Post) (US National Archives, 1947, 811.50/Recovery/4/2947). In
the fall of 1947, Robert

W.Tufts went with Colonel C.H. (“Tic”) Bonesteel and
Franklin Lindsay to Paris to confer

with the Committee of European Economic Cooperation
(CEEC)—a trip, Lindsay tells

me, that was particularly pleasant because Paris was not
yet jam-packed with Americans

working on the Marshall Plan. On 21 October 1947, there
were conversations with CEEC

representatives in Washington, with Tufts participating. On
25 October his name appears

on the roster of the newly appointed country analysis team
on France, under the chairman

ship of Woodruff Wallner. A memorandum from William
T. Phillips, of the Department of State’s International Resources Division (IR), with the assistance of William Bray (IR) and Robert W. Tufts (CP), expresses certain fears about the CEEC proposals on 4 March 1948 (US Department of State, 1974, p. 387). And on some date that I neglected to record, Havermeyer of IR wrote a memorandum expressing shock at the large amount of coffee to be provided to Europe under the European Recovery Program, with a copy to, among others, CP—Tufts. I do not mean to imply, nor would I have you infer, that Robert W. Tufts saved the world, if indeed it needed to be saved, alone. There were others in the act: notably, Secretary of State Marshall; Under-secretaries Acheson, Clayton, and Lovett; George Kennan of the Policy Planning Staff; Assistant Secretary for Economics, Willard Thorp; Messrs Bonesteele, Nitze, Lincoln Gordon, Cleveland, Ben Moore, Bill Phillips, Bill Bray, and many more; not to mention Lord Franks, Eric (now Lord) Roll, the late Robert Marjolin, et al in Europe.

But Tufts was present at the creation; as the contemporary Jack Paar might have said “He was there, Charlie.” Did Tufts, or rather dollars, save the world? Henry Hazlitt blamed the troubles of Western Germany on the Potsdam Agreement and the Level of Industry made under it, called the dollar shortage a myth that would have long ago corrected itself if it had been left free to do so, and enunciated sixteen principles of foreign aid, most of which indicated that with
intelligent policies in various quarters, it would have been unnecessary. His conclusion is

a little less flatly stated than his principles: “We might find, indeed, that the restoration of

free markets in commodities would make virtually the whole ‘Marshall Plan’ unnecessary”

(1947, p. 23) (emphasis added). Other contemporary economists of a classical persuasion thought that Europe’s economic problems could have been solved without a substantial aid program, sometimes expressing the formula as “balancing the budget and devaluing the exchange rate to the purchasing power parity,” in other cases offering the same substance more generally—

correcting the inflation and adjusting to an equilibrium exchange rate (Graham, 1949; Haberler, 1948; Harrod, 1947; Lutz, 1948). This early discussion has been followed lately by “revisionism,” partly political—suggesting that the United States aid to Europe was intended less to save European economies and standards of living than to prevent the adoption of socialist policies (e.g., Kolko, 1972)—but for present purposes mainly economic revisionism. A Belgian economic historian, Fernand Baudhuin (1958), drew a distinction between the Belgian government in exile that came back to Brussels in 1944 infected with British socialist interventionism, and the “theorists of Louvain” who stayed put during the war and consistently opposed regulation of all kinds. He concludes that experience has shown that Europe would have
been able to recapture its level of living by itself in a substantial way. Classical economists, among whom he counted himself since 1947, always believed that the apparent bankruptcy of Europe resulted partially from the inevitable consequences of war but, above all, from the fact that the nations continued to live in a state of refulgent inflation. I have already referred to the apostasy of Cleveland who played a prominent role in the Department of State thinking behind the Marshall Plan, but who has since renounced this position after his conversion to monetarism (1984). A Hungarian economist has lately blamed the need for United States assistance on American action in decontrolling prices in June 1946, the resultant substantial rise in prices of US exports being “the” main cause of the financial crisis of 1947 (Fodor, 1984, pp. 12, 36), or “a” main cause (ibid., p. 29). The most thorough-going revisionist analysis of the period, however, is that of Milward, who argues that there was no real likelihood of an economic collapse in Europe in 1947, and that the United States assistance merely sustained overly ambitious recovery programs (Milward, 1984, ch. 1, esp. p. 55). The more conventional views are that 1947 was a critical juncture in the development of European society and economy (Jones, 1955), and that the Marshall Plan was a qualified short-run success in restoring economic viability in Western Europe, but an enormous long-run success in the light of the European supergrowth that followed in the
1950s (Wexler, 1983, ch. 14). What does saving the world, or rather, let us say, Western Europe mean? It is easy to exaggerate and speak in hyperbole. When James Warburg and Lewis Douglas walked the streets of Washington most of the night of 18 April 1933, after President Roosevelt had informed them that he was accepting the Thomas amendment permitting a change of the gold price, Douglas said to Warburg: “This is the end of Western civilization” (Warburg, 1964, p. 120). A month earlier, a great many people had regarded the bank holiday as economic Armageddon, the end of the world. In actuality, one felt a certain uplift and release from impending doom, like the pleasure one takes in a 24-inch snowstorm or a hurricane that does not come too close: “One touch of nature makes the whole world kin.” But saving the world means something. We know what life-saving means. Death is irreversible, and if one is rescued from death, one’s life is saved. For a country or an area such as Western Europe, the question is a little more complex. Short-run catastrophe may be overcome in the long run. The fall of the Roman Empire brought on the Dark Ages, but this was followed centuries later by the Italian Renaissance, and then by the Risorgimento. A lender of last resort staving off imminent bankruptcy of a major institution may advance recovery by only a few years. By not coming to the rescue of Austria in May 1931 at the time of the failure of the Creditanstalt, France and the United States did not destroy the world, for the
world recovered in due course after

a fateful depression and a fateful war. Timely action would have “saved the world” in the

sense of avoiding widespread unemployment, loss of income and possibly, but by no means

certainly, the rise of the National Socialist Party in Germany to power with its devastating

consequences. The Third World today is desirous of avoiding default on its syndicated bank

borrowing because the record of the nineteenth and twentieth centuries shows that after

a default it was necessary to wait a generation—twenty-five to thirty years—before the

defaulting country can gain readmittance to the world capital market to borrow for its eco

nomic development. Economic salvation is far from a clearcut concept. It does not imply

the forestalling of the sounding of Gabriel’s trumpet, but it is action to prevent interruption

in normal economic processes that may last for considerable periods of time, varying from

several years to one or more decades, to centuries. Saving the world politically may evidently be something different where the country in

question is rescued from a totalitarian revolution, Nazi or Communist, that would destroy

underlying democratic processes. Making the world safe for democracy is a slogan of great

irony today. Distinction is nonetheless useful between the fall of a government in a two

party or pluralist system where the ousted group has the possibility of returning to power

when new elections come up, and one where the prospect of future elections is cast in seri
ous doubt. It is true that some democracies under certain circumstances need to be saved from deadlock, where, for example, no government can survive long because it is voted out of power as soon as it tries to govern, say, by proposing to raise taxes to balance the budget.

France had ten finance ministers in almost as many governments between September 1924 and July 1926—twenty-two months—until it was saved by the Poincaré administration. I would call this salvation, although the point is moot. Note that Milward tends to be sarcastic in calling attention to Jefferson Caffery’s warnings to Washington from the embassy in Paris that another French government was likely to fall (1984, pp. 116–17). We can address the issue in two ways: first, by weighing the statement that there was no need to save the world because the world was not in fundamental trouble and, second, on the assumption that the trouble was serious, assessing the view that there were one or more other means of saving Europe, that would have been used if the dollars had not been made available. On the first score, Milward finds little evidence of economic disturbance in 1947, although he notes that the harvest was the worst in Europe in a century and that the surpluses available from Eastern Europe before the war were no longer on hand (ibid., pp. 3, 31–2). He dismisses Undersecretary Clayton’s view of grave distress, leading to a break down of market connections between city and countryside. Evidence for this outside of
Western Germany he finds far from convincing (ibid., p. 13). The level of living fell in 1947 in France and Belgium, but it was “most improbable” that conditions elsewhere were worse in 1947 than 1946, except for Italy (ibid., p. 17). Food consumption was below that of the spring of 1946 in four countries in 1947—Denmark, France, Sweden, and Britain—though in Britain this applied only to meat, and in Austria, Germany, and Italy calorific intake would not sustain health for long (ibid., pp. 17–18). For France, the evidence is too sketchy to permit generalization, even though there were difficulties in obtaining wheat from farmers throughout the summer and wheat was mixed with maize (Indian corn) (ibid., p. 19).

Despite these statements, there were, in his summary, “very few indicators of economic crisis in 1947” (ibid., p. 55)—a conclusion that one reviewer, Gary Walton, finds “convincing” (1985, p. 987). Milward observes that figures for levels of living are “abstract, partial, and in many cases not very accurate,” and that statistics give a “very impressionistic and superficial answer to the question whether social conditions were deteriorating or not” (1984, p. 16). “Food figures are themselves not so convincing as to lead to a categorical, historical judgement” (ibid., p. 17). But he does not suggest that such data as existed tended systematically to overstate the trouble, as opposed to being distributed normally around the central tendency. The qualifications in Milward’s analysis and his need to be convinced of crisis before
approving action by the United States raise the central question of where the burden of proof lay in judging 1947 conditions and what risks it was prudent to have taken. Suppose the chance of breakdown without Marshall Plan aid was not fifty-fifty but only one out of three. Would a prudent and responsible outside government be justified in spending some billions of dollars to reduce such a risk to one out of ten? Milward asserts that the Marshall Plan was conceived and initiated by the Department of State for political objectives and that it represented a bureaucratic effort by that department to return to a position of pre-eminence in the making of national policy. “Any more realistic, purely economic view of the situation, such as that taken on occasions by the U.S. Treasury, tended to be judged as of lesser importance” (ibid., p. 5). It is clear that the Marshall Plan was steeped in political economy, but the idea that the bureaucratic interest of the Department dominated the national interest—a notion very much in accord with cynical political theory in which civil servants’ utility functions play major roles in shaping policies (Frey, 1984, p. 33)—is supported neither by evidence presented by Milward nor by any recollection that I have. These recollections consist mainly of economists, tired from the war and from foregoing holidays, working endless hours of overtime and in most cases anxious to return to the academy. Moreover, the Treasury’s more realistic, purely economic
view escapes this observer. In a superficial perusal of the archives, the only sharp difference between Treasury and State that sprang to the eye occurred in a meeting of the Interdepartmental Committee on 28 February 1948 when the Treasury argued that the success of the European Recovery Program depended on allocating more substantial aid to the United Kingdom, Belgium, and Norway in the first three months of the program (second quarter of 1948), if necessary at the expense of the Bizone (Germany), France and Italy. The State Department strongly opposed such a reallocation on the ground that the political necessity of saving Italy, France, and Austria from serious economic retrogression and undesirable political changes outweighed any possible disadvantage from a modest reduction in the United Kingdom’s hoped-for increase in reserves to support its role in the world trading system (US National Archives, Department of State, Lot File 122, Recovery, Box 13107, 17A). These minutes were written in the Department of State and may be somewhat slanted. As they read, however, they argue for the State Department’s realism in the face of a condition, and the irrelevance of the Treasury view, pursuing a theory. Milward twice brushes off the 1947 harvest, saying that its impact would be felt only in 1948. I have no idea where this view comes from. Agricultural bureaucrats are fully aware that the harvest comes in once a year and should be eaten only in equal installments, with
a carryover for seed and emergency. As a student of economic history, moreover, I am aware that the state of the harvest may have a decisive outcome on economic and political events in the short run. In the British debate between the currency and the banking schools during and after the Napoleonic Wars, the currency school held that the depreciation of the pound, or agio on gold, was the sole result of overissue by the Bank of England—a position close to that of Cleveland today. Thomas Tooke, the Bank of England, and the banking school in general wrongly dismissed note overissue altogether, based upon a real bills doctrine, but had a point in attributing some part of the depreciation, especially in the short run, to British crop failures, increasing the demand for imports, to the Continental blockade, cutting off exports, and to subsidies for Britain’s Continental allies, operating on the exchange rate directly. To widen the issue from the exchange market to economic and social distress, consider the Irish potato famine, or the role of potato blight on the Continent and the disastrous wheat crop of 1846 (the worst in a century to that time) that contributed to the Revolution of 1848 in France and Germany, and brought about an irreversible change in fertility in France—irreversible, that is, until World War II. Food riots were commonplace in nineteenth-century Europe (Tilly, Tilly, and Tilly, 1975). I drew a strong negative reaction from Gottfried Hab
erler, unconnected with any period, when I once suggested that bumper crops and crop failures had strong balance-of-payments consequences. In classical economics, the balance of payments was completely determined by monetary, fiscal, and exchange policy, although the OPEC shocks may have sown other thoughts. Milward (1984, p. 19) notes that France suffered strikes in June 1947. High Communist votes there and in Italy were the product of a complicated interplay of political aspirations, defeat of hopes... background of booming business conditions and falling real wages. Difficulties in collecting wheat from the French farmers in the summer of 1947 were the result not only of the "catastrophic harvest" but also of misguided pricing policies (ibid.). This raises the delicate question of causality and counterfactuals. If one insists that US aid supported misguided economic policies, does it follow that without that support economic policy would have become optimal? Moreover, optimality in terms of collecting grain from farmers may be wide of optimality in coping with the simultaneous, but somewhat different, if related, problem of the distribution of income between city and countryside. I see no way to judge the Milward-Charles Maier claim that given some economic difficulties in 1947, there was little danger of an irreversible political break, such as the take over of the French and/or Italian governments by Communist parties. Maier is ambiguous.

At one point he states: "Had not the fearsome winter of 1946-47 paralyzed transportation,
impeded food and fuel deliveries and radicalized workers into explosive wage demands,

recovery might have continued” (1981, p. 343). This sounds as though the Marshall Plan was really needed to restrain left-wing attempts to seize power. But later down the same page he asserts, somewhat tentatively: “Europe would probably not have ‘gone Commu

nist’ or collectivist even if the United States had not intervened with the same resolution” (ibid.). Milward’s conclusion is that “Defeat of the more radical aspirations in Western Europe has been shown to be part of the course of internal political development..rather than the result of American intervention” (1984, p. 91). No source is given for this state ment, although earlier in the discussion he cited Maier (1981, just quoted) and Schuker (1981). But Schuker disagrees with Maier about the danger from the left (ibid., p. 357).

In his view, American economic aid “provided the crucial margin...that eliminated bottle

necks...coaxed hoarded goods and gold on to the market, and paved the way for the all

important conquest of inflation (ibid.). It is, of course, impossible to specify precisely the political counterfactual to the Mar

shall Plan—whether gradual subsidence of the threat of Communist takeover or outbreak of revolt, but the question here again is not the exact betting odds, but the right fail-safe

course at some affordable cost. The West German condition in 1947 has given rise to an interesting debate between a

revisionist economic historian and two in the main stream.
Abelshauser (1987, forthcoming) tends to take the position that the Marshall Plan was not needed in Germany because the country had abundant labor, and was capable of producing the necessary capital over time through personal savings. This is a long-run macro-economic analysis that assumes that capital is malleable and capable of being redirected in the relatively short run. Over the long run, of course, capital had been taken out of one industry and diverted to another through depreciation and depletion allowances, but the process is time-consuming. In the short run, many industries that would properly be liquidated in the long run as excessively capital intensive can be revived with only small investments to piece out gaps. As a consequence, the industrial structure that one would arrive at with long-run analysis will differ sharply from that achieved with a succession of investments made in the short run. Immediately after the war, I was struck by an analysis by an economist of German origin and interested in German problems. He assumed that German comparative advantage would shift from capital-intensive to labor-intensive industries because of the reflux of Germans into the Western zones from Eastern Europe, including the People’s Republic, and the war time destruction and depreciation of capital (Bloch, private discussion). When, however, I asked Jan Tinbergen at Harvard in the 1950s whether Dutch planners had ever contem
plated reordering the economic structure of the Netherlands because of capital destruction

and the cutoff of Dutch emigration that drastically altered the capital/labor ratio, he said

that such a course had never been considered. The Abelshauser theoretical solution of taking labor and capital as given, and reallocatable, and shifting to an appropriate production structure with new comparative advantage and disadvantage is a counsel of perfection or despair, and almost certainly a recipe for political disaster. Just as capital has only limited malleability and hence is shiftable among industries only gradually, so the target level of living is not readily mobile downward. There is finally doubt whether such a policy could produce balance-of-payments equilibrium in the relatively short run. Opposed to the Abelshauser classical malleable paradigm in which bottlenecks are opened up by market forces, Borchardt and Buchheim (1987, forthcoming) take a microeconomic approach to the Marshall Plan, and note that it stimulated German output because, in promising a flow of raw materials in the future, it allowed German industry, and particularly textiles that were studied in depth, to use existing stocks more freely because of the assurance of replacements. Their implicit counterfactual was great difficulty in importing materials, and hence material hoarding, keeping production levels down. It is significant that German monetary reform which came in June 1948 and gave a fillip to production and to willingness to sell output
out of hoards came shortly after the
onset of the Marshall Plan. The more interesting
counterfactuals are those of Milward and Cleveland. Milward
blames the dollar shortage of Europe in the summer of 1947
on excessive investment that
led to excessive imports of capital goods, but he fails
to specify whether these would have
been halted in the absence of aid. US aid, he says, did not
prevent starvation or speed recov
ery so much as to sustain ambitious expansionary policies
already in full bloom (1984,
p. 53). Wide trade gaps were allowed to grow, even when
there was no visible sign that
the United States would finance them; and losses of
reserves no longer led to changes in
economic course (ibid., p. 21). Western Europe rushed to
the precipice of international
bankruptcy (ibid., p. 37): in both France and Britain,
policy went ahead on the unspoken,
perhaps unutterable, assumption that the United States
would have to act (ibid., p. 50). Dan
ish foreign-exchange reserves dropped to half their normal
level by the end of 1947, even
below normal working balances (ibid., p. 52). There is a
temptation to argue against Milward, as many economists
have argued against
me on financial crises, that he is assuming that the
governments of Western Europe—with
the exceptions he makes for Belgium and Italy—were acting
irrationally. Or they may have
been succumbing to moral hazard, acting recklessly because
they were confident that they
would be saved from their folly. I grant that there are
times when markets, on the one hand,
or governments, on the other, seem mesmerized or catatonic in the face of substantial economic forces. Such does not seem to me to be the case at hand, however. If the dollar drain could have been readily slowed on the Continent, i.e. except for Britain and West Germany, by cutting investment as Milward claims, I can see no barrier to doing so. From 1 July 1945 to 30 June 1947, European countries had received assistance from the United States of $10.1 billion. In addition, they spent $3.3 billion of their own funds, consisting of $1.9 billion in gold, $990 million in dollar balances, cashed $215 million in dollar securities, $140 million borrowed short term from US commercial banks. They also purchased $50 million from the International Monetary Fund, quite contrary to the articles of agreement as this was a long-term arrangement masquerading as an ephemeral balance of-payments deficit. Half of the $3.3 billion was for France’s account, a country that paid out its gold with the greatest reluctance (Memorandum to US International Financial Committee, 5 December 1947, p. 3). The British balance-of-payments position was exacerbated by a drain of dollars to the rest of the world, including notably Canada, Argentina, and Belgium. Belgium collected half of the dollars that the Organization for European Economic Cooperation (OEEC) countries drew from Britain, cashing a great deal of sterling that had been held by Belgian residents or was received from other governments and firms in pay.
ments of debts. Much of this, Cairncross believes (1985), would have remained outstanding sterling liabilities in the absence of the British payments agreement with Belgium to July 1947. The fatalism of Britain in paying out the proceeds of the Anglo-American Financial Agreement is probably connected to the fact that it was a loan and not Britain’s own money. Just as investment decisions are harder to take when two separate firms have to agree and mesh their decisions, so a decision to cut off hemorrhaging of dollars from the British loan is more difficult to reach if the borrower and the lender have joint commitments. Britain approached the United States to cut down its payments for the British zone of occupation in Germany in December 1946, and for Greece and Turkey in February 1947. But the pay agreements with other countries had an economic, not a purely political origin, and were more difficult to undo in the light of the July 1946 loan agreement that called for the adoption of convertibility within a year. It would have been awkward to back off in 1946–7 before convertibility was generalized. France, spending its own money and gold, shows the great difficulty that government was in. The British case is closer to mesmerization or catatonia, owing to the need to bring the United States into the decision. It was clear that the adoption of convertibility was ill-advised, but it took six weeks before Britain and the United States could agree to its abandonment. One can properly put some of the onus on
the United States for not having seen earlier that the British loan would not achieve its purpose—because of price increases, an inadequate initial amount, and some laxness in negotiating with sterling holders. In my judgement, it is reasonable to say that the United States tried hard after World War II to avoid the World War I pitfalls of war debts and reparations. Initial plans included the United Nations Relief and Rehabilitation Administration (UNRRA) and the International Bank for Reconstruction and Development (IBRD), designed to provide relief, rehabilitation, reconstruction, and development, plus the proposed International Trade Organization (ITO) and the International Monetary Fund (IMF) to lay down rules for trade and to take care of trade imbalances in the short run. Time supervened between the end of the war in Europe and the ratification and start-up of the Bretton Woods institutions, so that the capital of the Export-Import Bank was raised from $1 billion to $3 billion in the summer of 1945, and the monies were used as assistance to Europe rather than for the primary purpose of stimulating US trade. Military aid was provided for occupied areas such as France, Austria, and Italy as they were liberated, and Government and Relief in Occupied Areas (GARIOA) for Germany (and Japan). After the second tranche of UNRRA was used up, the United States provided post-UNRRA relief alone. The American predilection for tidy schemes
that shines through the original UNRRA, IBRD, ITO and IMF plan went further to merge

a variety of specialized, ad hoc European bodies—the European Coal Organization, the

Emergency Economic Committee for Europe (EECE), and the European Central Inland

Transport Organization—into the Economic Commission for Europe (Rostow, 1981). There was a case to be made then, as Cleveland does now, for muddling through, coun

try by country, now Britain, now France, now Italy, now Germany, just as today there is

a case—a strong one in my judgement—for not trying to tie together and settle the Third

World debt problems in one complex negotiation. One could easily believe in 1947, how

ever, that the piecemeal ad hoc approach had broken down. United States administrations

had promised the Congress a number of times that their latest proposal would clean up

the problem, but continued to come back for more, and to violate the spirit of the initial

commitments by supporting, for example, IMF advances to the Netherlands and France

that were known not to be short term. One of the first to argue for a new overall approach

was Cleveland. I have been unable to put my hands on the Cleveland-Moore-Kindleberger

document that has gained a certain amount of notoriety (Jones, 1955, pp. 242–4; Beloff,

1963, pp. 14–15). [Since presenting this paper in May 1986, I have located the text of the

paper, portions of which are presented above as Chapter 1.] This was completed sometime

in May—Beloff says “fairly early”—but did not get through
the typing mill until 12 June

1947, a week after the Marshall speech at Harvard. Cleveland was the principal instigator

of that effort. Moreover, there is an indication of his interest in an overall approach to Euro

pean recovery nine months earlier in October 1946. The United States National Archives

contain a memorandum of William A. Salant of the Division of German and Austrian Eco

nomic Affairs referring to a Cleveland memorandum on “European Reconstruction Survey,

Stage 2,” that showed dissatisfaction with the country-by-country approach. Since his conversion to the monetarist faith, Cleveland (1984) believes he was mistaken

to have pushed for an overall approach and should have been readier to tackle problems

country by country. He now waves away Germany as likely to continue to be fed by the

United States government because the bureaucrats would not want to give up GARIOA.

I resist the temptation to chide him for disloyalty to the old school tie, but cannot forbear

from suggesting that he lacks an adequate memory of the bureaucratic life of the period.

The War Department and the State Department were each anxious to get Germany off its

budget and on to the other. Lucius Clay, the general in command of the Office of Military

Government, United States (OMGUS), for example, refused to spend dollars for lettuce

from the Netherlands, lemons from Italy, or the use of the ports of Antwerp in Belgium

and Rotterdam in the Netherlands with their savings in real transport costs, preferring that
the Department of State find aid for Belgium, Italy, and
the Netherlands (Clay, 1950, p. 59). I go further and think that Cleveland’s present
disdain for bureaucrats has a touch of
arrière-pensée in it: he stayed in government far longer
than many of us who panted to get
out after years in the army and government, with no
vacations and unlimited overtime. One
may show disdain for bureaucrats today and think, with
modern political science, that they
work for their own interest—prestige, power, and
influence—rather than that of the country
or the world (e.g. Frey, 1984, p. 33), but I, for one, have
a hard time squaring that with the
all-nighters indulged in in those days by people at the
level of Phillips, Bray, Tufts, et al. As for Cleveland’s
suggestion that Britain, France, and Germany might have been able
to borrow in New York through bond issues or bank loans, perhapes after the installation
of Churchill as Chancellor of the Exchequer, with Jacques
Rueff as Minister of Finance
in France, the figures quoted above of European borrowing in the two years after the war
on top of $10 billion of assistance are not encouraging. Borrowing came to $140 million,
European spending of own gold and dollar assets came to almost $3 billion. I have an
advantage over people who try to reconstruct the state of the New York capital market for
foreign lending in 1947–52 from memory or from strong prior belief in markets that always
work, in that I have written on this subject in a textbook close to the period: Excessive lending, international
disequilibrium, depression, the collapse of export markets, the notoriety given to certain questionable practices by bond promoters, all combined to turn the investor away from foreign bonds, except for those of Canada which are only quasi-foreign... The foreign bond fell on evil days. (Kindleberger, 1953, p. 327) Since 1930... private long-term (foreign) lending by banks has been limited to advances against gilt-edge security, such as gold, or to loans made with governmental guarantees. (ibid., p. 328) Recently there have been attempts by governments to stimulate foreign lending... Government can restrain private foreign investment but it cannot effectively stimulate it. The collapse of the market for foreign bonds in New York after 1930 has remained complete. Refunding issues are sold from time to time for preferred borrowers like Australia, Denmark and Norway, and an occasional new loan is made for a Canadian borrower. More than this it has been impossible to achieve. (ibid., p. 333) The difficulties in creating adequate institutions for international lending have been indicated... The breakdown of the market for private lending appears to have been well-nigh complete. Revival can come only slowly. In consequence, governmental lending has been needed to fill the gap. (ibid., p. 443)

I see no reason to change these rather pedestrian and banal statements written in the summer of 1952 after four years of the Marshall Plan. The possibility that the situation would have been drastically altered if there had been no Marshall Plan by the heroic entry on the scene of Churchill and Rueff does not strike me as plausible. Churchill had been voted out of power decisively in 1945, a war hero to be sure.

Jacques Rueff has enjoyed a marked gain in reputation in the 1970s among a group of monetarists and adherents of the gold standard associated with the Lehrman Institute in New York (Cleveland, 1976; Calleo, 1976a, 1976b), but the chances of his rising to high government office in the immediate postwar period were slim. I vividly recall the inability of top
French civil servants at the Council of Foreign Ministers’ meeting in Moscow in the spring of 1947, who had been Rueff’s students, to take him seriously. In the intervening forty years I have occasionally wondered whether my students were giggling at me behind my back.

But far-reaching monetary reform on which Cleveland presumably rests his case is not easily achieved, even with the power to govern by decree such as the British and Americans had in the Bizone. The Colm-Dodge-Goldsmith plan was devised in May 1946. Most of the time lost in putting it into effect two years and a month later was devoted to trying to get agreement with the Russians on a German-wide measure. But when that prospect was lost it took weeks to print a new currency and four months of detailed work by a great many experts to produce the necessary regulations (Möller, 1976). Monetary reform was never contemplated in Britain, and was quickly given up in Italy when the plates for the new money were stolen (Clough, 1964, p. 292n). In France monetary reform was debated after liberation, recommended by the socialist Pierre Mendès-France, but resisted by liberals on the ground that it would be “unpopular, unfair, arbitrary and ineffective” (Kuisel, 1981, pp. 182-3, 192). Belgian monetary reform was not far-reaching, and interrupted rather than reversed inflation. Even then it gave rise to all sorts of administrative problems that took a long time to resolve (Dupriez, 1947). Except for the highly successful German monetary
reform which was a complement not a substitute for the Marshall Plan, the postwar conver-
sions taken in 1945 in other European countries neither went very far nor accomplished much (Metzler, 1946 [1979]). It is Utopian to think that if there had been no Marshall Plan, internal domestic equilibrium leading to external balance could have been achieved in a reasonable time and have produced a drastic change in the attitude of foreign investors. Some monetarists believe today, with Cleveland, that the solution of the Third World debt problem is for the banks to sell off large portions of their claims in the private mar-
et. Such faith in the capacity of markets to respond with elastic demands to virtually any offer of supply is touching. One of the faithful mentioned in my hearing not long ago that some Third World debt was being traded at 80, and thought the problem would be greatly ameliorated if much more could be sold at that price. I asked a New York banker about this.

He emphasized that the market was limited and that sales made at 80 were with recourse, meaning that if the debtor were to default the buyer had a residual claim on the selling bank. I cannot put credence in Cleveland’s counterfactual. There were other, and perhaps still more fanciful, counterfactuals offered inside Allied councils in Germany at the time. Cairncross, on the economic staff of the British delega-
tion to the Allied Control Council in Berlin, proposed importing a million tons of steel into Germany to prime the recovery, only to find that such an amount of steel was not available
The economics adviser to General Clay, General William Draper, wanted to borrow a billion dollars to import raw materials into the British and American zones (Clay, 1950, p. 196; Backer, 1978, p. 108), and Clay himself toyed with the idea of “borrowing” the gold stolen by Germany from the Allies, rather than returning it, in order to finance the import of raw materials. The first of these ideas made little sense in market terms, despite its authorship by a former Eastman, Dillon partner, and neither idea had the slightest chance of political acceptance in the United States or anywhere else outside Germany itself. Germany could not be helped positively and substantially by the United States separately from the Allies and such ambiguously placed countries as Austria and Italy, but only in the context of a European-wide scheme. When General Clay heard of the Marshall Plan, he cabled the War Department seeking at least $750 million in Category A imports (food, fertilizer, and gasoline), and $350 million in Category B imports (raw materials and semi-finished products) the first year and $500 million the second (Smith, ed., 1974, Vol. 1, pp. 377-81). Assume that Western Germany would be fed somehow. The question is how long it would have taken West Germany to refill its empty raw material bins through its own savings or by reestablishing its credit. Universal contemporary judgement was a long time. It is not clear to me that there is a
counterfactual hidden in Milward’s complex summary sentence on the last page of his first chapter: Thus, although there were very few indicators of an economic crisis in Europe in 1947, although the immediate difficulties of summer 1947 were no more than technical difficulties in making international payments, although the timing of these difficulties was attributable overwhelmingly to the domestic economic policies of European governments, and the difficulties could have theoretically been either postponed or avoided, although most of the structural changes of the international economy which were thought of as severe problems were only short-lived consequences of the war, and although in most European countries boom conditions with rising output, rising trade, and rising employment prevailed throughout the crisis, nevertheless the economic and political events of 1947 did constitute a crisis with the most profound implications… (Milward, 1984, p. 55)

The counterfactual to the Marshall Plan implicit in this analysis is presumably running out of dollars because of technical difficulties, then a change of policies to cut investment and/or or consumption through fiscal and monetary policy, and a devaluation of European currencies against the dollar. High implicit elasticities of supply for European exports and of demands abroad for the resulting output would lead these policies to overcome the short-lived consequences of the war. Rising output, rising trade, and rising employment would have forestalled political breakdowns. One can accept such an analysis for countries like Belgium, Denmark, Norway and Sweden, and, stretching it, even Britain and the Netherlands with their strong democratic traditions. But how long would it take to turn around France, Italy, and Austria—the first two with fragile governments—and how long would the United States patiently assist West
Germany, Greece, and Turkey? While recovery waited, what would happen to the trade of such countries as Belgium that needed to earn dollars in Europe to spend outside? Does the counterfactual include a willingness on the part of the United States to pay dollars to the rest of Europe for its exports to bizonal Germany when it was deeply disturbed by the idea of paying reparations to the Soviet Union by putting in aid to Germany when the Soviet Union was taking out reparations from current production? It seems to me that Milward’s adjectival body-English—“very few indicators of... crisis,” “no more than technical difficulties,” “could have... been postponed or avoided,” “short-lived consequences,” “rising output, rising trade, and rising employment”—papers over deep cracks in the European economy. It is easy to grant that the success of the Marshall Plan was exaggerated by the change from a bad harvest in 1947 to an average one in 1948, and that the original assumptions of the plan were drastically altered at the halfway mark by the outbreak of the Korean War. One can agree with Milward that the United States emphasis on European integration was excessively evangelical. On the other hand, the halting of discrimination by European countries against imports from other European countries—achieved for a time through the Intra-European Payments Scheme (IEPS) and then, more effectively, by the European Payments Union (EPU)—was a positive step that a country-by-country approach might easily
have missed. It is easy, too, to concede that the Marshall Plan was not sufficient to save Europe and the world. I find the argument that it, or something more or less like it, was not necessary, deeply flawed. Notes

I am grateful for comments on the original draft of this paper by Moses Abramovitz and Ben T. Moore.

1 There is a hint of analytical error in the association of excessive capital formation with imports of capital goods. Borrowing for capital formation can result in imports of food, if the resources that would otherwise have been used to produce food are reallocated to capital formation. And, of course, consumption can be increased by imports of capital goods, if the resources released are shifted to production for the consumer. See Charles P. Kindleberger, International Economics, 1st edn (Homewood, Ill.: Irwin, 1953), p. 307.


Beloff, Max (1963), The United States and the Unity of Europe (Washington, DC: The Brookings Institution).

Bloch, Kurt (c. 1948), private conversation.


Clay, Lucius D. (1950), Decision in Germany (Garden City, NY: Doubleday).


