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Why did Europe need the Marshall Plan in 1947? *

Giorgio Fodor

1. INTRODUCTION

Academics are often perceived by the general public as people with an exceptional capacity for wasting their time, one of their favourite occupations being trying to give complicated answers to irrelevant or banal questions. It is very likely that the title of this paper will be seen by many as falling into the category of questions that have an obvious answer, the answer presumably being: Europe needed Marshall Aid because of the physical devastation caused by the war. A more complete answer, I think, would run as follows: the devastation brought about by the war forced the European countries to devote all possible resources to reconstruction, thus reducing the volume of exports below their usual level while increasing the volume of imports above normal levels. This created a huge current account deficit with the U.S., the only country that could supply the food, the raw materials and the industrial machinery which Europe desperately needed for her reconstruction.

I have said that this would be the *presumable* answer because, as the question is not asked, it is extremely unusual for someone to consider this problem with any care. The devastation and the critical shortages prevailing in Europe during the early post-war period were so obvious that it is not surprising that they dominated the picture.

This was certainly the explanation offered in 1947 by the representatives of the European countries which, in response to the invitation of General Marshall, drew up reconstruction plans.

* An earlier version of this paper was presented at the conference "National and International Economic Reconstruction in Western Europe, 1945-1950", held on November 1983 at the European University Institute, Florence; I am grateful to Alan Milward for stimulating comments. A later version appeared in *Rivista di storia economica*, 1985, n. 1.

The facts and estimates contained in this and other Reports show that the problem of the dollar deficit of the participating countries reflects the fundamental fact that production in the American continent increased greatly during the war, while production in Europe fell to a very low figure and can only gradually catch up with the increase of production in the American continent. The problem of this dollar deficit is inevitably a continuing problem until the increase of production in the American continent is paralleled by as great or a greater increase of production in the participating countries [1].

A less radical version of this view, but which still emphasises only the problem of productive capacity, may be found in a paper written at that time by the director of research of the Council on Foreign Relations of New York.

In brief, the European Recovery Program in its present form represents an undertaking on the part of the United States to supply enough dollars and goods over a period of years to make it possible for the 16 participating countries of Western Europe to overcome the loss in productive capacity occasioned by World War II and to restore a viable, i.e., a self-sustaining, economy [2].

In this article I will argue that such an interpretation, although generally accepted as obvious, is too narrow.

After stressing that there was an *unexpected* crisis in 1947, data on European production are presented from which it is clear that recovery in production in physical terms was quite satisfactory; it is also shown that changes in the volume of European exports and imports explain only a relatively small part of the deterioration of Europe's balance of payments. Changes in invisibles plus changes in Europe's relations with the rest of the world were much more important. This paper gives particular significance to an often neglected factor: the change in the absolute level of U.S. prices after decontrol in mid-1946.

2. PARADOXES

There are two curious things to notice: the first is that the need for the Marshall Plan emerged suddenly in 1947, two years after the cessation of hostilities; the second is that the country that received most American aid was Great Britain, a country that after the war had a much higher level of

[1] Committee of European Economic Cooperation, *General Report*, July-September 1947, London, vol. 1, p. 65.

[2] P. W. BIDWELL, "The European Recovery Program, its Nature and Purposes", in *Germany's Contribution to European Economic Life*, Paris, 1949, p. 23.

output than before the war and where economic development was much more satisfactory than in Continental Europe. Furthormore, it should not be forgotten that two countries which suffered no war destruction whatever, Switzerland and Sweden, were included in the Marshall Plan.

On the first point an excellent UN report may be quoted:

> The first twelve to eighteen months after the close of hostilities were months of rapid economic reconstruction and recovery. The period since then was characterized by retardation of economic progress in so many countries that the year 1947 must be regarded as one of frustrated hopes[3].

Towards the end of 1946 a study by the Federal Reserve Board considered likely that the rest of the world would be able to finance its deficit with the U.S. without drawing heavily on reserves, that is, using current gold production, the funds of the new international economic organizations and the credits already granted by the U.S. government, but not yet used[4]. This hypothesis turned out to be wildly optimistic; instead of diminishing, the drain on reserves of the rest of the world accelerated dramatically in 1947. The case of the Marshall Plan countries is clear enough: their net sales of gold to the U.S. were $ 368 million in 1946 and $ 1447 million in 1947[5]. Equally illuminating is *when* Britain used the proceeds of the American Loan: in the second half of 1946 $ 600 m. were drawn, in the first half of 1947 $ 1450 m. and in the next two months $ 1300 m.[6]. Instead of diminishing, the dollar gap snowballed with the passage of time.

After the great optimism of 1946 frustration and deep pessimism seemed to prevail in Europe. The U.S. Administration was clearly taken by surprise by the turn of events. It had been convinced that after the big appropriations for the Bretton Woods institutions, for UNRRA and for the British Loan, plus emergency relief for liberated areas, no more big sums would be needed. Instead a dramatic crisis emerged. Secretary of State Marshall returned from Moscow on 28 April 1947, fearing total economic disintegration in Europe. He summoned Kennan the next day and gave him an astonishingly short period (about two weeks) to form a study group and propose a solution to the problem[7].

[3] United Nations, Department of Economic Affairs, *Economic Report. Salient Features of the World Economic Situation, 1945-47*, New York, 1948, p. 3.

[4] "International Transactions of the United States in the First Postwar Year", *Federal Reserve Bulletin*, December 1946, pp. 1333-34.

[5] United States Department of Commerce, *The Balance of International Payments of the United States, 1946-48*, Washington, D.C. 1950, p. 198, Table F.

[6] "The British Crisis", *Federal Reserve Bulletin*, September 1947, p. 1074.

[7] G. Kennan, *Memoirs, 1925-1950*, Boston 1967, pp. 325-6.

This explains the title of this paper: why *1947*? What had happened that had proved all the forecasts of the early post-war period to be wrong? It is interesting to note in passing that the year 1946 is usually treated with much less attention than the earlier or following years. Research has concentrated mainly on two questions: the reasons that prompted the U.S. to grant Marshall Aid and how European leaders used this aid to reinforce their position. These problems, clearly, do not deal with the preliminary question of why Europe did need the Marshall Plan. Those who are interested in why the United States did give help usually stress three points: fear of a post-war depression, interest in reconstructing world trade on a multilateral and non-discriminatory basis, and containment of communism. Because of this they tend to concentrate on post-war discussions made during or soon after the war, when fear of a post-war depression was widespread, or on a later period, when the Cold War had already erupted. This tends to result in a relative neglect of 1946, the year in which towards the end things started to turn sour from the European point of view.

The second important point that has to be considered is to whom the U.S. gave most of its aid. Of the total of net authorizations of the U.S. Government, that is, loans and credits available to foreign countries, between 1 July 1945 and 30 June 1947, over 55% went to only one country: the United Kingdom. Also from 3 April 1948, the day when the Marshall Plan started (apart from interim aid) to 30 June 1949 by far the largest share went to the UK, with over 30% of the total[8].

This is particularly interesting because the UK was one of the very few countries that emerged from the war with a far better industrial structure than the one she had in the thirties. Her industrial production had evolved much more favourably than that of other European countries. Compared with 1938 industrial production in the UK for 1946, 1947 and 1948 was 106, 114 and 128 respectively.

Foreign trade figures in volume show a surprisingly positive achievement. Already in 1946 the volume of British exports was above its 1938 level, while the volume of imports was below the pre-war figure. By the second half of 1947, when there was widespread fear for the future of the British economy following the collapse of sterling convertibility, the volume of exports was 15% above its 1938 level while the volume of imports was 23% below its 1938 level. The composition of exports had also improved, with 'modern' products becoming much more important. Exports of vehicles had more than doubled, those of electrical goods

[8] National Advisory Council on International Monetary and Financial Problems, *Report, 1 April 1947-30 September 1947*, 80th Congress, 2nd sess., House Document 501, Washington, D.C. 1948, p. 27.

increased by 79%, of machinery 68% and chemicals 46%. Traditional manufactured exports fell heavily, especially textiles, and although coal was vitally needed and its shortage retarded reconstruction, these figures show the modernization achieved by British industry. But the situation described is paradoxical: the U.S. gave most of its aid to the country that was better off and whose foreign trade had shown most progress.

3. INDUSTRIAL PRODUCTION

In order to verify the thesis that Marshall aid was necessary because of physical destruction, it is necessary to look at the figures for physical production. Global figures are available although they contain a wide margin of error and must be used cautiously. The picture they give is however reasonably clear. By the third quartier of 1946 industrial production in the countries that were to become participants in the Marshall Plan had almost reached the 1938 level and confortably exceeded it by the second quarter of 1947 if Germany is excluded. Including Germany, industrial production was about 80% of the 1938 level in the last quarter of 1946 and over 90% one year later[9]. By 1948, when Marshall Aid became operative, industrial production of ERP countries was above the 1938 level *including* Germany; excluding her it was about 20% higher[10].

If the figures for industrial production were relatively satisfactory, the same cannot be said for agriculture. Cereal production for participating countries plus Germany for 1946-47 was about 14% below the 1934-38 average. What is more important however is that the following year production fell further. Cereal production in 1947-48 was 15.6 million metric tons below the 1934-38 average, *but over 40% of this difference was due to the decline that occurred between 1946-47 and 1947-48*[11]. Clearly climatic conditions played an important part in worsening the European outlook in 1947. Already in 1946 meteorological conditions were abnormal, with a terrible drought in eastern Europe. Rumania's harvest in that year was about a third of its normal level; parts of the Soviet Union, like the Ukraine, suffered their worst drought in fifty years. 1947 started with terrible cold in Britain, France and Belgium, with heavy consequences for agricultural and industrial production; later drought fell on western Europe, once again damaging agriculture and (hydroelectric) electricity.

[9] Economic Cooperation Administration, *Second Report to Congress*, Washington D.C., 1949, p. 25.

[10] Economic Cooperation Administration, *Twelfth Report to Congress*, Washington D.C., 1951, p. 99, Table A1.

[11] Committee of European Economic Cooperation, *General Report*, vol. 1, p. 9.

This led some authors, like Woytinsky to assert that the 1947 European crisis was due in great part to an insufficient harvest[12].

What is clear is that, from this sort of very rough calculation, recovery in production was quite encouraging; from this point of view, it cannot be said that there was a general economic collapse in Europe as some very highly placed members of the Truman Administration seemed to fear. Indeed, the performance of the European economy was much better after the Second than after the First World War. As mentioned above, manufacturing production in OEEC countries, including Germany, had regained its 1938 level by 1948, that is, three years after the end of the war. After the First World War manufacturing production of the same countries regained its 1913 level more than six years after the end of the war; by 1924 it was still below 1913[13].

If we compare 1920 with July 1946/June 1947, that is, two years which start the same number of months after the end of hostilities in both world wars, industrial production of OEEC countries was 76% of 1913 in 1920 and 80% of 1938 in 1946-47 if we include Germany; excluding her the figures are 83% for 1920 and 95% for 1946-47. This includes mining, building and construction for 1946-47 but not for 1920; had it been possible to exclude these sectors for the second post-war period the comparison would have been even more favourable[14]. It could be objected that this comparison is unfair, because 1913 was a peak year while 1938 was a year of relative stagnation and that by comparing both post-war performances with these two years gives an unduly positive picture of the recovery after the Second World War. There are many factors that correct this distortion: apart from the fact that, as has already been mentioned, building and mining is included for 1946-47 which lowers the performance of this period, the index uses 1947 weights for the UK, whereas had 1938 weights been used, the second recovery would look still better. And it should not be forgotten that although both periods start fourteen months after the end of the war, 1946-47 includes the effects of completely abnormal weather.

Figures for investment are impossible to compare; in some countries they include repairs, in others they do not; furthermore, the element of depreciation is totally artificial, especially in the early post-war years. The following few generalizations may however be made: 1) in most European countries investment was channelled into heavy industry; 2) investment in

[12] W. S. Woytinski, *Dalla rivoluzione russa all'economia rooselveltiana*, Milan, 1966, p. 687.

[13] Organisation for European Economic Cooperation, *Industrial Statistics, 1900-1955*, Paris, 1955, p. 6.

[14] United Nations, Economic Commission for Europe, *A Survey of the Economic Situation and Prospects of Europe*, Geneva, 1948, pp. 15-18.

agriculture was usually neglected, although figures may give an excessively strong impression of this as they often do not include increases in livestock; 3) investment in stocks was extremely heavy. In the case of Norway and Holland probably more than 4% of national income in 1947 was devoted to the rebuilding of stocks of raw materials and consumer goods. A normal figure would have been about 1%. Finally, investment in transport was also abnormally heavy. Probably net investment in transport was as large as net investment in manufacturing; in the U.S. investment in transport in 1947 was about 1/6 of investment in manufactures [15].

It must be realised that giving priority to the expansion of heavy industry was a very risky strategy. It is possible that it was followed only because in some sense there was an awareness that if a crisis arose, it was likely that the U.S. would help.

4. FOREIGN TRADE

Concerning the problem of foreign trade, it would be reasonable to assume that the need for the Marshall Plan, which was after all a way to allow Europe to receive goods which otherwise she would not have been able to buy, was due to a big trade gap. A devastated continent had to devote all possible resources to reconstruction and therefore had to export less and import more than before the war. This possibility justified our reference to investment and rebuilding of stocks, above.

Looking at the figures, however, we notice that although it is certainly true that Europe's exports were much lower in volume in 1946 and 1947 than in 1938, also imports were below the 1938 level. Reconstruction did divert resources from exports; it was not however achieved through huge imports.

Notwithstanding the collapse of intra-European trade, caused in great part by the gap left by Germany, the purchases of ERP nations from other areas were lower during the reconstruction period than in 1938. According to ECA studies, in 1947 imports by ERP countries from other areas were 95% of those of 1938 (at 1938 prices), while exports were 75% of the 1938 level. By 1948 both the level of exports and imports from and to other areas were not very different from 1938 levels (92 and 94% respectively) [16].

[15] United Nations, Economic Commission for Europe, *Economic Survey of Europe in 1948*, Geneva, 1949, pp. 44-55.

[16] Economic Cooperation Administration, *Twelfth Report to Congress*, p. 106, Table A7.

5. THE EUROPEAN BALANCE OF PAYMENTS

It is clear from all this that it is impossible to understand the crisis in Europe's balance of payments by looking at data expressed in physical quantities. The Marshall Plan was necessary to solve a *financial* problem; to understand why it was needed one must study financial data, including prices. Figures of export and import volumes compared with their 1938 values give no indication of the balance of payments problem not least because although in 1938 Europe's current account was in balance, she had a huge trade deficit: the value of exports covered less than 2/3 of imports. With the U.S. the situation was worse: exports covered less than one half of imports. (This is using European data. Using American data Europe covered 2/3 of her imports from the U.S. with exports).

This made invisibles plus gold production in the Sterling Area key elements in paying for the trade deficit. This explains the paradox of the amount of American aid to Britain: British exports could well be above their 1938 level while import volumes were below their 1938 level, but this did not mean that Britain had ceased to have a trade deficit. And if account was taken of prices and invisibles, a foreign exchange crisis could easily coexist with an impressive improvement in export and import volumes from their pre-war level.

In 1938 Europe had a current account deficit with the U.S. of about $ 400 m. and a surplus of a similar amount with the rest of the world. Its total trade deficit of about $ 2.1 billion was covered for two thirds by income from investments, while the remaining third was covered with shipping, tourism, etc. There are some very interesting calculations made by the experts of the U.N. Economic Commission for Europe (ECE) on the deterioration in Europe's current account between 1938 and 1946. According to them, the main factor was the change in invisibles (48% of the total effect), the second was the increase in prices, which will be discussed below (35%) and only 16% was seen as due to changes in the volume of foreign trade[17]. Given the way in which Europe balanced its current account before the war, with invisibles paying for the trade deficit, it is easy to see how changes in other factors than the volume of trade could cause major changes.

Some considerations are however necessary. First of all, these estimates concern the whole of Europe and not only ERP countries. While the situation described fits very well the United Kingdom which represented a considerable share of Europe's overseas trade at the time, it is not indicative of the situation of other countries like Italy. Another point may

[17] Data from U.N., Economic Commission for Europe, *A Survey of the Economic Situation and Prospects of Europe*, p. 58.

perhaps be worth mentioning. The ECE, in which brilliant economists like Kaldor, Lary and Myrdal worked, has sometimes been accused of having had a too pessimistic outlook. Its estimate, published in 1953 [18], that Europe had to increase the volume of its exports by 80% in order to be able to import the same amount of goods as in 1938, due to the loss of foreign investments and merchant shipping as well as other factors like the new debts and increased military expenditure abroad, was gently criticised by Triffin [19].

There is an important point, however, that has to be kept firmly in mind. The figures discussed above refer to Europe's balance of payments with the whole of the rest of the world. But the key problem was Europe's dollar deficit, a very different matter. Destruction in Asia, the weakening of colonial links, increased domestic consumption in some overseas countries and the Cold War meant that Europe obtained less goods from non-dollar sources than before the war; very often she was forced to import from the U.S. goods which previously had come from other areas. Although this effect did not increase the overall deficit of ERP countries, the task of financing it became much more difficult. A clear example is given by trade with Eastern Europe: a zone which before the war had sent to Western Europe abundant supplies of agricultural goods and coal. With increasing East-West tensions, many of these supplies were no longer sent West, with the result that OEEC countries had to buy them overseas, frequently paying for them in dollars.

The deterioration in volume terms with the U.S. and Canada was much more serious than the one with the rest of the world. In volume terms by 1947 OEEC imports from North America were about double their 1938 level, while their exports to that area were about 80% of their 1938 level. There was therefore a deterioration in volume terms in Europe's trade with the U.S. But these changes in volume do not explain even half of the deterioration of Europe's balance of trade with the U.S. [20]. According to the BIS Europe's exports to the U.S. in 1938 were $ 0.6 bn. while her imports from that source amounted to $ 1.3 bn. A decrease of 20% in exports and an increase of 100% in imports would explain a deficit of $ 2.12 bn.; instead, in 1947 the trade deficit with the U.S. was $ 5.2 bn. Clearly prices were at least as important as changes in volume.

[18] United Nations, Economic Commission for Europe, *Economic Survey of Europe Since the War: A Reappraisal of Problems and Prospects*, Geneva, 1953, p. 13.

[19] R. Triffin, *Europe and the Money Muddle: From Bilateralism to Near-Convertibility, 1947-1956*, New Haven, 1957, pp. 39-40.

[20] See Organisation for European Economic Cooperation, *Second Report*, Paris, 1950, pp. 62-63; for data in current dollars see Banque des Règlements Internationaux, *Dix-neuvième rapport annuel*, Basel, 1949, p. 105.

6. NON-EUROPEAN COUNTRIES

It is also necessary to consider another theme: the dollar deficit of non-European countries. For Europe this meant that areas that had traditionally supplied her with dollars now became a dollar drain. As for the countries that had traditionally financed their deficits with the U.S. with a surplus with Europe, their huge dollar deficit inevitably forced them to demand dollars from Europe in a much more forceful manner. And it should be noted that in 1947 there was an abrupt deterioration in the dollar position of the non-European world that had serious repercussions for Europe's balance of payments.

Between 1946 and 1947 the net balance on goods and services of the U.S. improved sharply from $ 7.8 bn. to $ 11.3 bn. Of this deterioration in the position of the rest of the world vis-à-vis the U.S. only one-third was due to ERP countries; the rest originated in other countries. Indeed, it is worth noticing that countries that were not touched by the war had a much more serious deterioration in their dollar position in 1947 than Europe. Between 1946 and 1947 the net balance on goods and services of the U.S. improved by 28.4% with ERP countries, but by 68.7% with Canada and Newfoundland and by 220% with Latin American countries[21].

In the interwar period, the U.S. usually had a trade surplus with all areas except tropical countries and producers of some commodities such as copper. These commodities were needed in the U.S. and did not harm American producers, therefore tariff protection was low. But tropical countries imported little from the U.S.; their inhabitants were often too poor to afford the advanced products in which the U.S. were clearly superior. Usually also tropical countries were colonial dependencies and were forced to prefer supplies from their Imperial metropolis. In this way, plus the fact that they had to service their debts, India and Malaya earned dollars for Britain, as the East Indies did for the Netherlands. This changed drastically after the war. Asian colonies had suffered from the war and their capacity to export was temporarily reduced, while India, approaching independence and with huge sterling balances was unwilling to supply dollars to Britain.

For the Sterling Area the difference is striking: while in 1934-38 India (including what was to become Pakistan) plus Ceylon and the Colonies had a trade surplus with the dollar area of about 210 million dollars a year in 1947 they had a dollar trade deficit of about 136 million. Thus, while before the war their dollar surplus covered about 46% of Britain's dollar

[21] U.S. Dept. of Commerce, *The Balance of International Payments of the United States, 1946-48*, Washington D.C., 1950, pp. 198, 201-2, 204.

trade deficit, in 1947, instead of contributing to Britain's dollar problems, they aggravated it.

Australia, New Zealand and South Africa had a different trade pattern. They had rich white inhabitants who already in the interwar period could purchase the new products of the United States; furthermore, their geographical characteristics made them prefer lorries, tractors and cars of an American and not European type. As for their exports they often competed directly with American agricultural production, and faced protectionist barriers in the U.S. Their dollar trade deficit had averaged 140 million dollars in 1934-38; in 1947 it was 609 million.

Almost all the reserves of the Sterling Area were centralised in the 'Dollar Pool'[22]; the dollar deficit of the rest of the Sterling Area became a heavy burden for the United Kingdom.

Other countries which before had accepted payment in European currencies now demanded dollars or gold in order to alleviate *their* dollar problem.

A fact of enormous significance is that after the Second World War the U.S. had a trade surplus not only with the European countries ($ 8.5 bn. in 1946 and 1947) but with the rest of the world as well ($ 6.1 bn. in 1946 and 1947). This was in marked contrast with the experience after the First World War (1919 and 1920), when the U.S. trade surplus with Europe was $ 7.7 bn. but there was an American trade deficit with the rest of the world excluding Europe of $ 800 million. That is, in the second post war period, there was a 'dollar shortage' in the whole world and not just in Europe. The situation was particularly serious for countries who had traditionally financed their deficit with the U.S. with their surplus from Europe. Canada and Argentina furnish a good example: both countries had an extremely serious balance of payments crisis in 1947 although their current account remained in equilibrium. Their real problem was that they could not use their surpluses with some countries to pay for their deficit with the U.S.

In 1947 Canada had a current account surplus of C $ 85 m. but this was composed of a deficit with the U.S. of C $ 1135 m., a surplus with the Sterling Area of C $ 874 and a surplus with other countries of C $ 346 m.[23]. Notwithstanding its current account surplus and the fact that it obtained dollars from the Sterling Area and from other countries, by the end of 1947 Canada faced an extremely serious balance of pay-

[22] See K. M. Wright, "Dollar Pooling in the Sterling Area, 1939-1952", *American Economic Review*, 44, 1954, pp. 559-76.

[23] International Monetary Fund, *Balance of Payments Yearbook, 1948,* Washington D.C., 1950, p. 99. For a longer series, see M. C. Urquardt and K. A. Buckley, *Historical Statistics of Canada*, Toronto, 1965, pp. 162-63.

ments crisis. Foreign exchange reserves collapsed in a short period from C $ 1638.7 m. to C $ 461 m. and stringent direct controls had to be imposed on imports[24].

Argentina had a similar experience. Although its current account balance for 1947 was approximately in balance (the deficit was about 30 million dollars) the decline in her gold and convertible foreign exchange was about 700 million dollars. In great part this was due to the fact that her surpluses with Europe could not be used to pay for her deficits with the U.S. Not surprisingly the utmost pressure was exerted in order to obtain dollars in part payment for her exports to Europe, thus aggravating Europe's position[25].

The following table shows clearly the importance of this phenomenon for 1947.

Table 1.

Gold and Dollar Deficit of ERP Countries, 1946-47. Millions of dollars.

	1946	*1947*
Net imports of goods and services from the U.S.	4177	5363
Dollar net payments to third countries	327	2740
Financing needs	4504	8103

Source: U.S. Department of Commerce, The Balance of International Payments of the United States, 1946-48. Washington D.C., 1950, p. 174.

Between 1946 and 1947 the dollar deficit of ERP countries increased by a dramatic 80%, but less than a third of this was used to finance direct transactions with the U.S.; two thirds had to be used to contribute to solve the dollar gap of other countries.

7. THE IMPACT OF HIGHER U.S. PRICES

There was another factor of fundamental importance which is usually neglected in discussions of the 1947 crisis: the rise in U.S. prices. Given the enormous trade imbalance that already existed before the war between the U.S. and Europe, it was inevitable that an increase in dollar prices would increase the European dollar deficit in the same proportion even if no variations in volume occurred.

[24] E. P. Neufeld, *Bank of Canada Operations and Policy*, Toronto, 1958, p. 182.

[25] Banco Central de la Republica Argentina, *Memoria Anual, 1947*, pp. 44-45; I. M. F., *Balance of Payments Yearbook, 1948*, pp. 46-51. See also my "Peron's Policies Towards Agricultural Exports, 1946-48; Dogmatism or Common Sense?", in D. Rock, ed., *Argentina in the Twentieth Century*, London, 1975.

It should be noticed that this does not touch the question of changes in the terms of trade, which on the whole did not deteriorate as much as could be expected. They seem to have worsened for Britain and improved for Continental Europe; on the whole European terms of trade do not seem to have changed much, although in many cases this only meant that inflation accelerated without corresponding alterations in official exchange rates. In these cases, European countries had difficulties in selling in hard currency markets, where their products were not competitive, and had to sell in soft currency markets.

It may be useful at this point to give an indication of how much American prices rose. If 1938 = 100, the prices of the following products in January 1947 and January 1948 in the U.S. were: maize 242 and 493; wheat 234 and 333; raw cotton 354 and 391; lead 273 and 316. Weighting the main commodities according to each commodity's share in Europe's total imports from overseas in 1947 we have January 1947 243 and January 1948 301[26]. We therefore have at least a doubling of the pre-war level of prices by 1947 and a trebling for 1948. It will be seen below that prices in the U.S. rose abruptly only after June 1946 when the system of price control was in an acute crisis. The effect of this was disastrous because of the trade unbalance that already existed in 1946: in that year U.S. merchandise exports to ERP countries were $ 4383 m while their merchandise imports from those same countries were only $ 757 m. These are figures for the whole year and therefore already include a good part of commodities that were sent to Europe when prices had already risen abruptly. It is clear that with such an enormous trade imbalance, a rise in U.S. prices even without a change in the terms of trade, was bound to have a devastating impact on Europe, as the dollar value of the trade deficit increased in the same proportion as the level of prices.

We have already seen the importance of changes in invisibles for Europe's balance of payments between 1938 and 1946. It is now necessary to explore the causes of the worsening that occurred in Europe's current account between 1946 and 1947, which was of $ 1700 m. It must be stressed that in this case ECE data is being used which covers the whole of Europe and not only ERP countries like the table reproduced above. In 1947 income from overseas investment increased by $ 100 m., so it is necessary to explain a deterioration of about $ 1800 m. in the other items of Europe's current account. According to the U.N's ECE, only $ 250 m. are due to changes in quantities imported and exported, while $ 1550 m. are explained by the increase in the absolute level of prices[27]. More than

[26] United Nations, *Economic Survey of Europe in 1948*, p. 95.

[27] According to the calculations of the United Nations, Economic Commission for Europe, *A Survey of the Economic Situation and Prospects of Europe*, p. 58.

90% of the deterioration of that crucial year, 1947, is explained by this last factor.

Clearly these calculations contain many debatable elements, but they are reproduced to give an idea of the importance of the subject discussed. Using other weights the results could change very substantially, as Triffin makes clear while calculating the deterioration of the current account of OEEC countries between 1938 and 1947.

Wide discrepancies in the estimated breakdown of the 1938-47 deterioration of the balance of payments between the impact of volume changes and the impact of price changes originate in the choice of different base years in these calculations. The – $ 6.7 billion deterioration in Europe's balance can thus be alternatively broken down into a – $ 3.6 billion volume impact (at 1938 prices) and a – $ 3.1 billion price impact (at 1947 volumes), or into a – $ 7.2 billion volume impact (at 1947 prices) and a $ 0.5 billion price impact (at 1938 volumes)[28].

This example should instill a healthy diffidence towards statistical comparisons which claim great accuracy when important structural changes have occurred. While Triffin's example weakens the ECE's calculations which compare 1938 with 1946, it is much less serious for changes which occurred between 1946 and 1947, that is, in only one year. It is clear that in this case changes in the absolute level of prices were undoubtedly very important.

The new level of American prices had many effects for Europe. The main one was that it halved the real value of European gold and dollar reserves (about $ 10 bn. for ERP, countries). It also discouraged current gold production and increased the proportion of it which ended up in private hoards; clearly this was at the expense of official reserves at a time when they were desperately needed. A third important consequence was that the real value of Europe's portfolio investment in the United States was reduced, as the price of American shares lagged behind commodity prices while fixed interest securities remained at their old price because interest rates did not move.

The lack of worry about this problem during this period is astonishing. A striking example is given, remarkable enough, by the experts that met in Paris in 1947 precisely to give content to the Marshall Plan. In the General Report of the Committee of European Co-operation there is an appendix on the balance of payments, where the causes of the 'dollar problem' are listed. Three reasons are given: *a*) reduction of invisibles; *b*) deterioration of the terms of trade; and *c*) reduction of supplies from South-East Asia and eastern Europe that had to be replaced with imports from the U.S.

[28] R. Triffin, *Europe and the Money Muddle*, Statistical Appendix, Table 7, p. 313, note.

Although the report mentions the fact that the participating countries as a group usually imported from the American Continent "more than twice as much as they exported", the experts did not realize that this meant that a doubling of prices automatically meant a doubling of the dollar deficit. On the contrary, the Annex on the Terms of Trade concludes:

> The assumption that the prices of exports will be unchanged and that the prices of imports will be reduced is made in order to put the matter in a simple form. In fact no doubt the prices of both exports and imports will vary; but what matters is the relative change in import and export prices[29].

There is absolutely no awareness of the fact that, given the existing trade imbalance, a rise in the absolute level of prices could have a devastating impact on Europe's balance of payments. It is even possible to find in some excellent publications of that time comments which consider American inflation positive for Europe. Perhaps this was a residue of the discussions after the First World War, when higher American prices were seen as beneficial because higher international prices reduced the real burden of reparations and war debts. A good example in 1947 is given by *The Statist*. When Congress was refusing to renew price controls in the U.S., it published a totally mistaken analysis of its possible impact on Europe.

> Yet American prices cannot be considered *in vacuo*. For our net position with reference to the United States depends upon the *relative* movements of sterling and dollar prices.

And it concludes

> To take a realistic (but by no means cynical) point of view, a steady tendency to rising prices both here and in America over the next few years may well lighten the real burden of repayment of debt to the United States without doing harm to the creditor[30].

8. THE ROLE OF GOLD IN INTERNATIONAL PAYMENTS

As mentioned above, the doubling of dollar prices not only halved the real value of the foreign exchange reserves of European countries; it also had a similar effect on their gold stocks, due to the fact that the dollar

[29] Committee of European Economic Cooperation, *General Report*, vol. 1, p. 73.
[30] "American Price Level", *The Statist*, July 6, 1946, p. 2.

price for gold had not changed. Moreover, there were other adverse consequences, as gold was not only a very big element in European reserves; it was also one of the most important commodities that earned dollars for Europe, although in an indirect way.

To understand better how inflation affected negatively the role of gold in the early post-war period, it is illuminating to review briefly the role of gold in the thirties when, through a rise in its real value, gold contributed powerfully to restore international equilibrium.

The financial crisis of 1931 and the devaluation of sterling made it only too clear that the gold exchange standard, that had been recommended by the 1922 Genoa Conference because of fear of a probable future shortage of monetary gold, was a very dangerous system. Central Banks suffered tremendous losses on their sterling assets and, not surprisingly, frantically liquidated their remaining foreign exchange holdings, converting them into gold. In a very short period the percentage of foreign exchange on total reserves for the Central Banks of the main 24 countries of Continental Europe collapsed from 42% to 8%. Naturally this drastically reduced the global amount of international liquidity available[31].

But the reduction in the value of international liquidity was soon compensated by three main factors which were related to gold. The first was the fall in commodity prices, the second was the generalized devaluation of currencies and the third was an abrupt increase in gold production as well as massive private dishoarding. The first two factors raised the real value of the existing gold reserves; the third increased the amount of physical gold available for monetary purposes.

Commodity prices, especially of commodities entering international trade, fell heavily. By 1932 gold prices of world trade were less than half those of 1929[32]. This clearly resulted in an increase in the real value of existing gold reserves. This was reinforced by devaluations, caused either by capital flight, or by the vain hope of raising commodity prices (as in the U.S.), or by beggar-my-neighbour policies. Although at the end of the cycle of devaluations some key exchange rates were not very different from those prevailing at the beginning of the period there was an enormous difference. The market value of gold stocks had risen by about 70%, in line with the change in the dollar price of gold from $ 20.67 to $ 35, while dollar commodity prices in the thirties were below their 1929 level.

In this painful and roundabout way the real value of international reserves was restored.

The third factor, related to the amount of gold available for monetary

[31] League of Nations, *International Currency Experience: Lessons of the Inter-War Period*, Geneva, 1944, p. 235.

[32] League of Nations, *Review of World Trade, 1933,* Geneva, 1934, p. 10.

purposes deserves close examination. The main gold producing countries had also devalued: on average the price of gold in terms of their domestic currencies had risen by about 76% between 1929 and 1936, while the price of goods had fallen by about 15%. This made gold production enormously profitable, and in a world ravaged by depression and starved for markets, gold producers were about the only ones with a guaranteed buyer for their whole output at an extraordinarily favourable price. It is not surprising that in such conditions gold production increased impressively. Between 1929 and 1939 the physical amount of gold mined increased by 85%, while the dollar value of each ounce had grown by almost 70%. The reaction of gold producers is all the more striking if the strategy of South Africa, the world's largest producer, it taken into account. There, it had been decided to use the high price of gold not so much to increase production as to mine lower grade deposits, leaving the richer deposits for leaner times. Because of this, South Africa's share of world gold production fell from 55.7% in 1929 to 37% in 1939; excluding South Africa world production increased by an amazing 162.6% between 1929 and 1939[33]. This was reinforced by massive gold dishoarding in the East, which in 1932 amounted to about one half of world production.

All these factors combined made it possible for the world's stock of monetary gold to increase between 1929 and 1939 from $ 11.4 billion to $ 31.3 billion, that is, more than amply compensating the gap that had been created by the collapse of the gold-exchange standard[34].

The experience of the thirties has been discussed in so much detail in order to show the contrast with the early post-war period. All the factors that in the thirties had helped gold to alleviate the shortage of international liquidity now worked in reverse, although Europe desperately needed financial resources to pay for imports.

First of all, the dollar price of gold remained fixed at $ 35 an ounce although dollar prices had doubled. This halved the purchasing power of the $ 10 billion of dollar and gold reserves available in 1945 (of which $ 7673 m. were in gold)[35] to the European countries that participated in the Marshall Plan. The fact that the value of gold did not rise in line with the price of other commodities rendered obsolete all forecasts made towards the end of the war on the financial needs of the European countries during the reconstruction period, which were made without envisaging a strong rise in American prices.

[33] United Nations, *Statistical Yearbook*, 1948, New York, 1949, pp. 154-156; League of Nations, *International Currency Experience*, pp. 17-18; J. M. KEYNES, "The Supply of Gold", *Economic Journal*, 44, 1936, pp. 412-18; W. A. BROWN, Jr. *The International Gold Standard Reinterpreted, 1914-1934*, New York, 1940, vol. 2, pp. 1310-11.

[34] Data from W. J. BUSSCHAU, *Gold and International Liquidity*, Johannesburg, 1961, p. 75.

[35] Banque des Règlements Internationaux, *Dix-huitième rapport annuel*, Basel, 1948, p. 134.

This was not the only negative effect of the fact that the official price of gold did not change: there were also serious repercussions both on the amount of private hoarding and on the volume of gold production. Now the official price of gold in terms of commodities had become cheap. This led to hoarding, that is, an increase in private gold stocks at the expense of monetary stocks. Precisely when international liquidity was most needed, a big part of gold production was unavailable for this purpose. In the thirties the private sector had released gold, therefore the increase in the world's monetary stock had been higher than world gold production: in the post-war world the opposite happened. In 1946 over half of the production of gold of the world disappeared into the hands of the public. Troubled conditions in many parts of the world were certainly important, especially in China. A good part of the explanation was however in Europe. The Swiss National Bank, for instance, was selling in 1946 one million Swiss francs worth of gold coins a week to the public; after mid-1946 this was raised to 3 million. Although it demanded a written pledge from buyers (who had to be Swiss nationals) not to re-sell these coins, a part of them ended up abroad, where gold had a premium on the black market ranging from 170% in Paris to 200% in Lisbon[36].

Towards mid 1946 the price of gold on the free Swiss market was about $ 70 per ounce; such a high value cannot be explained, as in other countries, with distrust in the national currency. At the time, in the free market in Zurich, the dollar as quoted with a discount of 30% in Swiss francs. Before 1948 the gold sales to the private sector by the Swiss National Bank amounted to approximately $ 350 m.[37].

There were controls on gold producers to stop them from selling all their output on the free market, and gold production was discouraged by the new relationship between higher costs and fixed prices. If we exclude the Soviet Union, where the relationship between price and cost was not of primary importance in determining the output of gold, and South Africa, whose output remained more stable for the reasons mentioned above, gold production in 1946-7 was less than half that of 1935. Part of this was due to the ravages of war, but the economic factors were important, although some countries decided to subsidize gold producers. Between 1939 and 1946 gold output in Canada fell by 44%; in Australia by half.

The case of Canada is very interesting. Towards the end of 1947, faced with a serious foreign exchange crisis caused by its inability to finance its trade deficits with the U.S. with its trade surpluses elsewhere, Canada

[36] "Unwanted Gold", *The Statist*, Sept. 7, 1946, p. 212.

[37] *Federal Reserve Bulletin*, Sept. 1954, p. 951; for more details see E. Hochuli, *Die Schweizerische Gold- und Dollarpolitik vom Beginn des Zweiten Weltkrieges im Herbst 1939 bis zur Pfundabwertung im Herbst 1949*, Stuttgart, 1967, p. 114; and E. Mächler, *Die schweizerische Gold- und Devisenpolitik nach dem zweiten Weltkrieg (1945-1949)*, Zurich, 1952, pp. 51-55.

decided to subsidise gold production with $ 7 per ounce. Before the war, the value of Canadian gold production had been about half of Canadian exports to the U.S.; now gold production was menaced by rising costs and fixed prices. The subsidy was strongly opposed both by the International Monetary Fund and by the U.S. The IMF claimed that it was in contrast with article IV, section 2 of the Fund Agreement:

> The Fund shall prescribe a margin above and below per value for transactions in gold by members, and no member shall buy gold at a price above par value plus the prescribed margin, or sell gold at a price below par value minus the prescribed margin[38].

The day after the IMF made its position clear, the Secretary of the U.S. Treasury declared that the U.S. would not regard with favour the tendency, apparent in some countries, to rely on subsidised gold production to achieve and maintain equilibrium in their balance of payments[39].

Whether gold had to be revalued was sometimes heatedly debated. Not surprisingly the United States were totally opposed to the idea. They were the ones who had to give the necessary resources and wanted to have a tight control of which goods were to be given, to whom and when. Because of this they had avoided using the U.N.'s Economic Commission for Europe for this process, and encouraged the creation of the OEEC. A revaluation of gold would have made much of the process automatic, withouth giving any political advantage to the U.S. and even favouring economically the Soviet Union. There were also other reasons. In the thirties the U.S. had been blamed for devaluing the dollar against gold while having a very strong balance of payments position. To devalue the dollar at a time when everybody had a deficit with the U.S. would have seemed nonsensical and would have not been accepted by Congress. There was also at the time a deeply felt diffidence towards gold, and it was widely argued that a revaluation of the precious metal would divert scarce resources from reconstruction to gold mining. The South African Minister of Finance, Havenga, could attack the U.S. by pointing out that it was only too advantageous for some countries to sell their exports at post-war prices while buying gold at its pre-war price[40], but others were more cautious. By buying gold in unlimited amounts at $ 35 an ounce, the U.S. were guaranteeing a minimum price for gold. Chiefley, the Australian

[38] For the IMF declaration on subsidies to gold production, see *The International Monetary Fund 1945-1965*, Washington D.C., 1969, vol. III, pp. 225-26. For the tough position taken by the IMF on private gold transactions at prices above official prices, see *Keesing's Contemporary Archives*, Jan. 24-31, 1948, pp. 9068-69.

[39] Banque des Règlements Internationaux, *Dix-huitième rapport annuel*, p. 130.

[40] "L'Afrique du Sud doit s'incliner: le prix de l'or ne sera pas relevé", *Vie Française*, Sept. 16, 1949.

Prime Minister was reported to have declared: "There's only one buyer of gold — the United States. It might stop buying"[41].

The main effect of the fixed dollar price for gold was on the Sterling Area. Before the war, this area had an annual trade deficit with the dollar area of about $ 450 million; at that time, gold production in the Sterling area was about $ 550 million. This shows the enormous importance of gold for Britain; the impression is further reinforced if one compares gold with the other main dollar earners of the Sterling area before the war. Compared with over $ 500 million for gold, exports of the two main commodities to the U.S. were: rubber $ 113 million and tin $ 58 million (1934-38 averages). Total U.S. imports from the UK in that same period averaged only about $ 150 million. In these conditions, even if the United Kingdom had managed to treble her exports to the U.S., this would not have been enough to compensate the harm done to the Sterling Area by the fall in the real price of gold.

After the war the role of gold in the balance of payments in the Sterling Area had clearly changed. The decline in physical production was about 13%, the real problem however was that its price had remained fixed. In 1946 the gold production of the Sterling Area covered only 1/3 of the dollar trade deficit of the U.K. Had its price doubled or trebled like so many other commodities the balance of payments of the U.K. would have been very different. To say that it would have been in equilibrium is clearly impossible, because a higher gold price would have meant larger dollar imports in South Africa and could also have changed the very complex ties between South Africa and the Sterling Area, that were in a period of rapid change. Still, a lower level of prices, or a higher level in the price of gold, would have improved the balance of payments of the U.K. very significantly.

The possible connection between the price of gold and the need for the Marshall Plan did not go unnoticed to some particularly acute abservers. But they do not seem to have expressed themselves as bluntly as a French publication with a very small circulation.

> Dans ces conditions, on peut conclure que, tout au moins dans le cas de la Grande Bretagne, le Plan Marshall aurait été superflu si le prix de l'or avait subi la même courbe ascendante que celui des autres matières premières[42].

Seen from the point of view of the U.S. the picture is equally clear. The U.S. economy had traditionally had a trade surplus. This made gold a crucial item in supplying the rest of the world with the necessary means of

[41] "Gold. Its Function in Restoring Sanity", *Financial Times*, Aug. 31, 1949.

[42] "Dévaluation des Monnaies ou Relèvement du Prix de l'Or?", *La Correspondance Economique, Technique, Professionnelle*, April 12, 1949, (mimeo), Paris, p. 2308.

payments to buy in the U.S. In 1938 total U.S. imports were $ 1960 m. while world production of gold (excluding the U.S.) was $ 1141 m. and U.S. net gold imports amounted to $ 1973 m. The fact that in that year net gold imports into the U.S. were similar to total U.S. imports shows dramatically how a substantial change in the commodity value of gold inevitably had to upset the world's international financial equilibrium. During the inter war period the dollar gap had been bridged in good part with gold exports by the rest of the world; in the second postwar period, instead, this possible way out suddenly disappeared.

It should not be thought however that a doubling or even trebling of the dollar price of gold would by itself have solved the problems of the rest of the world vis-à-vis the U.S. In 1947 world gold production was about 24 million ounces while the U.S. trade surplus was about $ 10 bn. For *current* gold production to equal the U.S. trade surplus a price of more than $ 400 per ounce would have been necessary. Still, it should be remembered that gold stocks are very large if compared with gold production and that the function of reserves is to finance temporary disequilibrium. In 1947 ERP countries sent to the U.S. about 41 million ounces while their deficit in goods and services with that country was about $ 5 bn. Had the price of gold in terms of U.S. commodities not changed in the early post-war period Europe's situation would have improved substantially, although clearly serious problems would have remained.

In later years, a growing awareness of the importance of the role of gold for international financial equilibrium made discussions on the possible consequences of increasing its price more frequent. It was the first of the various ways of increasing international reserves explored in a UN report of 1951 in which the level of reserves was considered inadequate[43]. In early 1952 there was again fear of a generalised dollar shortage; by then it was well understood that raising the official price of gold could be an alternative to more American assistance. In the City of London three *alternative* solutions to a generalized dollar shortage were being discussed: 1) another Marshall Plan; 2) a new devaluation of sterling and other commodities against the dollar, and 3) an increase in the dollar price of gold[44].

9. THE END OF PRICE CONTROL IN THE UNITED STATES

It is important to stress that most of the increase in American prices did not occur during but after the war; 70% of the rise in wholesale prices

[43] United Nations, *Measures for International Economic Stability*, New York, 1951, p. 34.

[44] Agence France Presse, *Service Economique,* "Les problèmes mondiaux de l'or", Feb. 25, 1952, p. 2, (mimeo).

between 1939 and 1948 occurred *after* the surrender of Japan. And, interestingly enough, despite a relaxation of price controls, inflation was low until June 1946, when Congress refused to renew a stringent Price Control Bill. Between August 1945 and June 1946 wholesale prices rose by only 7%. Prices exploded, as will be seen, after June 30, 1946, and this had a very wide impact also on commodity prices from other areas. About two weeks later, Peron wanted to charge for Argentine meat the new U.S. prices for meat, which had doubled in a few days; this would have meant trebling the price of Argentine beef. London managed to resist, but the episode illustrates the speed with which the new decontrolled American prices made an impact on the prices asked by other countries. In effect, a new international price ceiling was established[45].

An interesting question is why the difficulties created for Europe by the rise in American prices have not been sufficiently emphasised. As mentioned above, at the beginning the problem was not understood. Later, however, in some specialised studies the issue emerged more clearly, but it was usually dealt with inside statistical tables or technical notes, and was not stressed. At that point, the U.S. had already started the Marshall Plan; to underline the damage suffered by Europe because of the increase in American prices would have allowed opponents to the Plan to claim that the U.S. were giving with one hand what they had taken away with the other. The truth however is that the economic policy of the U.S. in this period was particularly confused, being the unforeseen result of opposing tendencies led by Congress, President Truman, the unions and the business sector.

In order to understand its evolution during this period it is necessary to remember that there was a widespread conviction that a sharp depression was inevitable in the early postwar period. The experience of the first postwar period, together with the acceptance of very simplified 'keynesian' models contributed to this intellectual climate. Using models with a constant propensity to consume, and which envisaged a sharp fall in Government expenditure, it was not difficult to obtain worrying results. There was an official forecast of eight million unemployed for the spring of 1946.

It may be mentioned that these mistaken forecasts had an important impact on the development of economic *theory* in the U.S. After some time it became quite clear that the problem was inflation, not deflation, and this, for example, forced economists to consider consumption functions which depended not only on current income. But the most impor-

[45] L. W. CHANDLER, *Inflation in the United States, 1940-1948*, New York, 1951, p. 216. The importance of a rise in the international price ceiling has been stressed, for a later period, by S. Biasco. See his *L'inflazione nei paesi capitalistici industrializzati. Il ruolo della loro interdipendenza, 1968-1978*; Milan, 1979, pp. 29-36. For Peròn's speech, see *The Times*, July 19, 1946.

tant consequence was that it created an atmosphere in which some economists felt confident enough to carry a frontal attack on keynesian theories.

While economists who used a 'keynesian' approach (like A. Smithies, J. Mosak, R. G. D. Allen, M. Kalecki and E. Hagen) had predicted mass unemployment, more conservative economists who had warned on the danger of inflation had been proved right. W. Woytinski, who however cannot be called conservative (he had spent years in jail as a social democratic agitator under the Czar and later promoted an important plan of the German trade unions to fight depression with public works during the last period of the Weimar republic) is a good example of this intellectual climate hostile to keynesian ideas. Commenting on some thirty forecasts for the postwar period, he writes:

> The outstanding feature in the distribution of errors is that nearly all forecasts classified as "erroneous" were supplied by proponents of the Keynesian theory, while most of the predictions originated by other schools — in the government or private agencies — proved to be correct, at least for the transition period. The probability that this distribution of errors is unrelated to theoretical differences is extremely small... If we discard the probability of an accidental distribution of these errors, we conclude that the source of the mistake must be somehow related to the Keynesian philosophy[46].

It could be objected that the impossibility of knowing with any precision how fast soldiers would be demobilised made it impossible to produce even crude forecasts. Also, at least in one case a 'keynesian' forecast (by L. R. Klein) proved quite accurate, although it was not published at the time. It may also be mentioned that there was a widespread conviction that a slump would follow the end of the war also among non- keynesian economists[47].

The Administration did not have a clear policy for wages and prices, and the early termination of the war caught it unprepared to deal with this problem. The sudden surrender of Japan rendered obsolete the hypothesis of a gradual demobilisation, which was based on the idea that the war in the Pacific would continue for one or two years after the end of the war

[46] W. S. Woytinski, "What was wrong in Forecasts of Postwar Depression?", *Journal of Political Economy*, 55, April 1947, pp. 143-44.

[47] In Switzerland, for example, one investigation financed by the Association of Retail Merchants, envisaged a depression; T. Keller, *Die Gefahren des Preiszerfalls nach dem gegenwärtigen Krieg und die Massnahmen zu ihren Bekämpfung*, Zug, 1943. Johr's forecast, instead, on prices in the postwar period made a distinction between those countries which lost the war and those which won it; there was furthermore a distinction between winners with a strong economic structure and those with a weak one; W. A. Jöhr, *Die Nachkriegsdeflation*, St. Gallen, 1945, pp. 237-38. Also in Nazi Germany it was believed that prices would fall after the war; H. Rittershausen, "Die Zusammenhänge zwischen Finanzpolitik und Preispolitik", *Finanzarchiv*, n.s. 8, 1941, pp. 477-539.

in Europe. With peace, the tacit no-strike, no lockout agrement between labour and management came to an end. Unions were impatient, as average weekly pay was reduced by the diminution of overtime and the forced shifting of labour to less well-paid jobs. Due to these causes in February 1946 weekly pay was about 14% lower than in April 1945; in the meantime prices had risen[48].

At the same time many employers wanted a rise in their prices as a compensation for the fact that they had been forced by the end of the war to concentrate on a less profitable product mix. As early as August 1945 the steel industry had asked the Office of Price Administration (OPA) for a substantial rise in the price of steel because of the decline in demand for its more profitable products[49]. While during the war the Government demanded special products without too much regard for price, private demand was more concentrated on standard products.

Under this sort of pressure, the OPA, under its very able chief, Chester Bowles, felt that the best defence was to allow changes in wages and prices as rarely as possible; any major concession would have meant a flood of similar claims. If for example, the steel industry was authorised to raise its prices, how could it be possible to deny a similar concession to the innumerable industries which used steel as an input? And with higher prices higher wages would become inevitable. It would have been impossible to maintain control against both the wishes of labour and employers; in particular, conflicts in the labour market looked menacing. But it was felt that even if more freedom was granted to labour to ask for higher wages a firm control on prices could be an effective method of containing these claims. Employers would resist wage increases in a much more determined way if they knew that they would not be able to transfer higher costs to prices. If increased costs had been taken as a reason for higher prices competitive pressure among firms eager to establish themselves in the post-war markets would have made them too anxious to avoid strikes and the consequent loss of markets to rival firms.

Wage policy passed through three main phases in a very short period: after the end of the war labour partly regained its freedom; wage increases were allowed if they did not require higher prices from the OPA. In October free collective bargaining was restored and it was established that firms had to wait for a six month period before asking for higher prices. At this stage a link had been established between costs and prices, albeit not

[48] "Causes of Labor Strife", a declaration by the President of the American Federation of Labor to the Special Subcommittee of the House Labor Committee, July 1, 1946; published in the *Commercial and Financial Chronicle*, July 4, 1946, see in particular p. 137.

[49] B. J. BERNSTEIN, "The Truman Administration and the Steel Strike of 1946", *Journal of American History*, 50, 1965, p. 792. Bernstein's articles are essential to understand the problems and tensions of the reconversion period.

an immediate one. The third stage started de facto in February 1946, when increased wages and increased prices in the steel industry were announced simultaneously[50].

The delicate question of relative variations in prices and wages inevitably became political. Those who, like Wallace, feared a new depression, favoured higher wages with fixed prices. They believed that in this way the higher propensity to consume of the private sector would compensate for the smaller role of the State in the economy. For business, on the other hand, it became clear that profits were menaced and that it was essential to prepare the battle against the renewal of the Price Control Bill that was to expire in mid-1946.

Key political issues inevitably emerged. The CIO under Walter Reuther demanded a guarantee for fixed prices in its strike against General Motors, claiming that profits were sufficient to cover increased wage costs. General Motors replied that wages had to be determined by conditions in the labour market, and that to use "capacity to pay" as a factor would introduce a radically different type of social organization; it also refused to open its books to inspection and rejected Truman's suggestions for a conciliatory solution. To avoid political isolation the company made the good point that if their profits were considered to be excessive the correct solution was for the OPA to order a reduction in prices in order to benefit all consumers. There was no reason why only General Motors workers should benefit[51].

In early 1946 there was an explosion of strikes, as labour tried to regain purchasing power and firms resisted in order to defend their profits. Steel production, vitally needed for world reconstruction, was stopped for a month. Coal, another vital commodity of which there was an acute shortage, suffered a two month stoppage in April and May. About 90 million tons of coal were lost. Firms could afford strikes because of a provision of an early post-war Bill that allowed losses incurred in 1946 to be deducted from the excess profits tax paid during the war. This had been done to encourage investment in a period in which firms feared a slump; its unforeseen result was that 85% of the cost of the 1946 strikes fell on the Treasury and not on enterprises.

Controls were becoming unworkable, especially after the increase in the price of steel, a commodity that entered into so many other commodities. Ideologically the Administration was on the defensive, as it could

[50] For more details, see B. J. BERNSTEIN, "The Truman Administration and its Reconversion Wage Policy", *Labor History*, 6, 1965, pp. 214-31.

[51] For the attitude of the management of General Motors towards unions and in particular the CIO, see A. P. SLOAN, Jr., *My Years with General Motors*, London, 1965, pp. 405-6, where mention is made of the union's tendency to try to influence price policy. On the strike, see B. J. BERNSTEIN, "Walther Reuther and the General Motors Strike of 1945-46", *Michigan History*, 49, 1965, pp. 260-77.

not claim that in the long run a controlled economy worked better than a free market one. The only thing it could do was to ask for a litle more time and to warn about runaway inflation if controls were lifted. But its prestige was very low, and its mistaken forecasts about a post-war depression had seriously diminished the credibility of its inflation forecasts. By 1946 it was evident to everybody, including the Government, that the danger was inflation.

The ideological pressure was very strong, as can be seen by a statement by the President of the National Association of Manufacturers.

> In peacetime, your government refuses to restore your economic liberties which were given away in wartime. Mussolini, Hitler, and Hirohito convinced the world in our time that individual liberty is inseparable from economic liberty. Today I speak for the return of the liberties we have lost[52].

At the end of June 1946, Congress instead of renewing a strong Price Control Bill approved an extremely weakened version that was in effect a Bill for the rapid dismantling of controls. Deeming the Bill unworkable, Truman vetoed it; a period of utter confusion followed when there were no controls whatsoever and there was great uncertainty about the future. Prices exploded, and on 25 July 1946 a new, although much diluted Price Control Act was passed. It may be mentioned that Truman signed this Bill in a very skeptical mood[53]. Price ceilings were reimposed on many commodities, but by now many producers were determined to win their struggle for free prices. It had been difficult enough to keep prices from rising; to lower them to their previous level proved impossible. Politically, the key issue became the control of the price of meat. Cattle was kept away from the market. In the brief interlude of no price controls meat prices had risen by 70% in a few days and slaughtering had been too high. In September and October meat was unobtainable at official prices "and public opinion showed very clearly that it preferred to have meat at market price rather than no meat at all at controlled price"[54]. It is perhaps possible to recapture the feeling of the period in a Nero Wolfe detective novel.

> It was smack in the middle of the Great Meat Shortage, when millions of pigs and steers, much to the regret of the growers and slaughterers, had sneaked off and hid in order to sell their lives dear, and to Nero Wolfe a meal without meat was an insult[55].

[52] R. WASON, "A Business Man Looks at the National Economy", *Commercial and Financial Chronicle*, Aug. 1, 1946, p. 608.

[53] "President Dubious of New OPA Act", *Commercial and Financial Chronicle*, Aug. 1, 1946, p. 609.

[54] "America and Inflation", *The Statist*, Dec. 7, 1946, p. 5.

[55] REX STOUT, "Before I Die", in *Trouble in Triplicate* (1st ed., New York, 1949), New York, 1974, p. 1.

Maxy Americans felt the same way. With elections approaching rapidly, Truman was forced to lift price controls on meat on 14 October 1946; in a week the wholesale price of meat increased by 93%.

This made the early end of price controls inevitable, as other producers began to withhold supplies in expectation of higher prices. On 5 November the Republicans, who had made the issue of a free economy and tax cuts central to their campaign, made enormous gains. In the old House of Representatives there were 241 Democrats and 192 Republicans; in the new House there were 188 Democrats and 246 Republicans. Defeated, on 10 November Truman lifted price controls, with the only exceptions of residential rents, sugar and rice[56].

In order to keep price controls it had been necessary to follow a very rigid policy that was against granting price increases in most cases. But the relative prices of the war period produced more and more distortions in the transition period, when the structure of demand was shifting rapidly. The abolition of controls was therefore caused not only by political factors but also by economic reasons.

With the Cold War approaching and stoppages and shortages appearing with increasing frequency, it was perhaps inevitable that controls could not survive. The clearest case was agriculture. In early 1946 there seemed to be a famine ravaging Central Europe, in great part due to a wheat shortage. Yet at the end of 1945 wheat consumption in the U.S. was about one third higher than in the same period of 1944. The reason was that the price ratio between maize and hogs made it profitable for farmers to feed hogs with their maize and not to sell maize on the market. Those who raised poultry and livestock using corn were forced to feed them with wheat, thus reducing supplies available for export. Chester Bowles, who felt ashamed at the amount of food that was on his table while Europe was menaced with starvation was in a dilemma. The Administration had promised that maize and hog prices would not be increased; yet the price relationship was distorting supplies. If the Administration yielded its credibility would be weakened further; if it kept its word starvation might follow. In the end, not surprisingly, the Administration yielded[57].

10. CONCLUSIONS

The main outline of this paper may now be reviewed. The problem to be explained is why Europe's need for the Marshall Plan appeared only in

[56] See M. McCULLOUGH, "Price Administration, Office of", in C. EARLE FUNK, ef., *The New International Year Book, 1947*, New York, 1947, pp. 520-21.

[57] B. J. BERNSTEIN, "The Postwar Famine and Price Control", *Agricultural History*, 38, 1964, pp. 235-40.

1947 and why there was a balance of payments crisis in that year. We have seen that the performance of the indices of physical production were much better than after the First World War, when no need was felt for anything resembling the Marshall Plan. On the contrary in the twenties many felt that Europe could repay her war debts to the U.S.

Looking at trade figures in volume makes it clear that volume changes were not a crucial factor in the deterioration in Europe's position. Comparing 1946 with 1947 the main factor is in the change in the absolute level of dollar prices, not because of the effect on the terms of trade but because Europe's trade with the U.S. had always been in deficit, and a doubling of all prices meant a doubling in the dollar deficit even if no change in volume had occurred.

In the past Europe had equilibrated its balance of payments with the dollar earnings of her colonies plus invisibles plus the gold production of affiliated countries. After the Second World War, the rest of the world also had a dollar deficit. In contrast with what had happened after the First World War when the rest of the world had helped to solve Europe's dollar problem, now Europe had to give dollars to non-dollar countries. The non-dollar countries had become a heavy dollar burden.

The 1947 crisis was mainly a financial crisis, in the sense that production continued to recover but Europe seemed to be running out of dollars and gold to pay for vital imports. The end of price controls and the rapid inflation in America had very severe effects on Europe's balance of payments position: it doubled the existing dollar trade deficit while the purchasing power of Europe's gold and foreign exchange reserves was halved at a crucial moment; it also reduced the real price of current gold production with negative effects on the volume of output and on private hoarding.

The relationship between the American control of prices and the Marshall Plan may be seen in the following way. Europe needed a certain net amount of goods from the U.S. With her reserves, plus the British Loan, plus relief aid it seemed for a time that she could finance her needs for a reasonable amount of time, perhaps even until world trade returned to more normal conditions. But also American consumers wanted goods, and they had accumulated liquid resources that were vastly greater than Europe's. Compared with the $ 10 bn. that Europe had at the end of the war, the private sector in the U.S. had bank deposits and Government paper for $ 228 billion[58]. Much of this was in the hands of people who wanted to purchase goods as soon as they became available. Seen in this perspective, the rise in prices and its effect on Europe's capacity to pur-

[58] E. A. GOLDENWEISER, *American Monetary Policy*, New York, 1951, p. 197.

chase dollar goods is no accident. It is the natural outcome of a process of free bidding by different groups. The 1947 financial crisis simply reflected that Europe could not bid successfully against American consumers (as well as other foreign countries) for scarce goods. Marshall Aid may perhaps be seen as an intervention by the U.S. Government to prevent U.S. consumers from outbidding Europe. Goods were bought and sent to Europe with money taken away from the American public through taxes; at the same time it proved necessary to reimpose strigent export controls in the U.S. on some key commodities to prevent other countries with higher reserves from taking them away.

If we see the problem as a struggle between U.S. consumers and Europe for a certain amount of goods, there could have been a deterioration in Europe's position even if the amount of goods she needed had not increased significantly. Clearly there could have been another solution: the maintenance of price and administrative controls. This was perfectly clear to some U.S. economists during the war, most notably Hal B. Lary at the Department of Commerce. His exceptionally acute forecast is worth quoting.

> The real heart of the immediate post-war problem, however, will not be so much an initial general lack of purchasing power but a relative abundance of accumulated dollar reserves and the strength of demand, both domestic and foreign, in the face of a continued though temporary shortage of things — goods and possibly also ships. Until these shortages are made good, only one solution is possible: continuation of allocation of supplies to meet the most urgent needs, rationing to the individual consumer, price control, and restraints in the liquidation of savings[59].

In this sense the 1947 crisis can be seen as a financial crisis that reflected a problem of distribution more than a crisis of production. For the reasons discussed above it was not easy to maintain strict controls in peacetime, politically it was much more difficult than had been envisaged by planners during the war. The consequent rise in prices was a market way to solve the problem of allocation of supplies. The problem was that it dealt a devastating blow to Europe, although many both in Europe and in the U.S. were not aware of this.

This raises another interesting problem: would a U.S. post-war recession have *helped* Europe? In the forties there was a widespread fear in Europe of the cyclical instability of the U.S. economy, and those who opposed an open world economy mainly did so on the grounds that such

[59] U.S. Department of Commerce, *The United States in the World Economy*, Washington, D.C., 1943, p. 22.

an organization of world trade would have made Europe too vulnerable to a U.S. depression. Ironically enough, if the analysis presented here is correct, a U.S. recession would have had quite a few redeeming features for Europe.

As mentioned, Europe had always exported very little to the U.S. and therefore a fall in U.S. demand would not have had a significant direct effect on employment in Europe. A recession would have significantly reduced the purchasing power of American consumers and perhaps caused a fall in prices or at least a less strong rise. This would have meant that with her reserves and the current gold production of affiliated areas Europe would have been able to buy more American goods and American consumers less — all this, however, out of a reduced volume of U.S. production.

A comparison with the first post-war period may be instructive to underline some differences. After the First World War there *was* a very sharp but short depression, with the consequent collapse in prices. In little more than a year the export prices of American food products and raw materials fell to less than half their maximum level achieved during the boom[60]. This helped Europe inasmuch the real value of her gold reserves increased. There were however two negative aspects: the first was represented by the enormous war debts of European countries towards the U.S., the second was that the American depression reduced the surplus enjoyed by tropical countries with the U.S. At that time, these countries had a trade surplus with the U.S. and a deficit with Europe[61]. Precisely this structure of international trade had been used in the U.S. by those who opposed granting credits to Europe after the First World War. In a letter of the Secretary of the Treasury to the President of the Chamber of Commerce of the U.S., it was said that:

> this country cannot continue to extend credits on a sufficient scale to cover our present swollen trade balance against Europe, while paying cash (gold and silver) to the countries of Central and South America and the Far East with which it has an adverse balance on its own and international account[62].

After the Second World War, these aspects did not exist. There were no war debts, only some loans to finance the transition period. Had American prices fallen, the use of these credits would have lasted longer.

[60] See data in I. MINTZ, *Cyclical Fluctuations in the Exports of the United States Since 1879*, New York, 1967, p. 304.

[61] Clearly the main source for the structure of world trade is League of Nations, *The Network of World Trade*, Geneva, 1942, written under the guidance of Folke Hilgert.

[62] Letter of Jan. 26, 1920, in U.S. Dept. of Commerce, *The United States in the World Economy*, Washington D.C., 1943, pp. 139-40.

And tropical countries had a deficit with the U.S. If after the First World War the American slump had diminished their surplus, after the Second it would probably have had the beneficial effect of diminishing their deficit. The lack of a buoyant American market would had changed the attitude of the rest of the world; it would had been more willing to sell to Europe against soft currencies.

But all these are abstract discussions and fortunately it was not necessary to have the horrors of a depression to reestablish a certain equilibrium in Europe's external payments. The gifts of the Marshall Plan solved the problem for some years, but the heavy trade deficit with the U.S. persisted for a long time after the end of the Plan. Still in 1956 and 1957 the exports of continental OEEC countries to the U.S. were less than one half of their imports from the U.S.[63]. It is not surprising, therefore, that when the Marshall Plan ended, many believed that it had *not* solved the problem of the dollar gap.

> The magnificent experiment of the Marshall Plan came officially to an end at the beginning of this week. Of its original objectives, the restoration of prewar standards of industrial economic production in Western Europe has been more than achieved...
>
> Only one of the aims has eluded the Marshall nations. In spite of nearly doubling their exports to North America between 1948 and 1951, their dollar deficit, which stood at over $ 5 billion in 1948, still stood at nearly $ 4 billion in 1951. The dollar gap remains, although the Marshall Plan is over.
>
> The failure of the plan in this respect must be attributed not to any lack of generosity on the American side or to any lack of effort in Europe. It failed because it was based upon the false assumption that the restoration of Europe to prewar levels of activity would in itself restore the prewar balance and pattern of world trade[64].

What cannot be doubted is that the lifting of controls in the U.S. in 1946 had a dramatic effect on Europe, reactivating inflation in many countries and aggravating the balance of payments. All this teaches us once more that to understand what happens in a country or group of countries it is not enough to study them. It is essential to look at what happens in the centre of the world economy. The dollar was the world's key currency. An abrupt change in the commodity value of the standard had, as always, an enormous impact on the world economy.

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[63] U.N.; I.M.F. and I.B.R.D., *Direction of International Trade*, 11, n° 9, 1960, p. 45.

[64] "After the Marshall Plan", *The Economist*, July 5, 1952, p. 1.