

Lecture 29: Thirty Glorious Years

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Econ 115

October 29, 2009

Digressions
Marshall Plan
Western European Political Economy
Social Democracy

Digression

Just because you are obeying the traffic lights does not mean that everybody else is doing so...

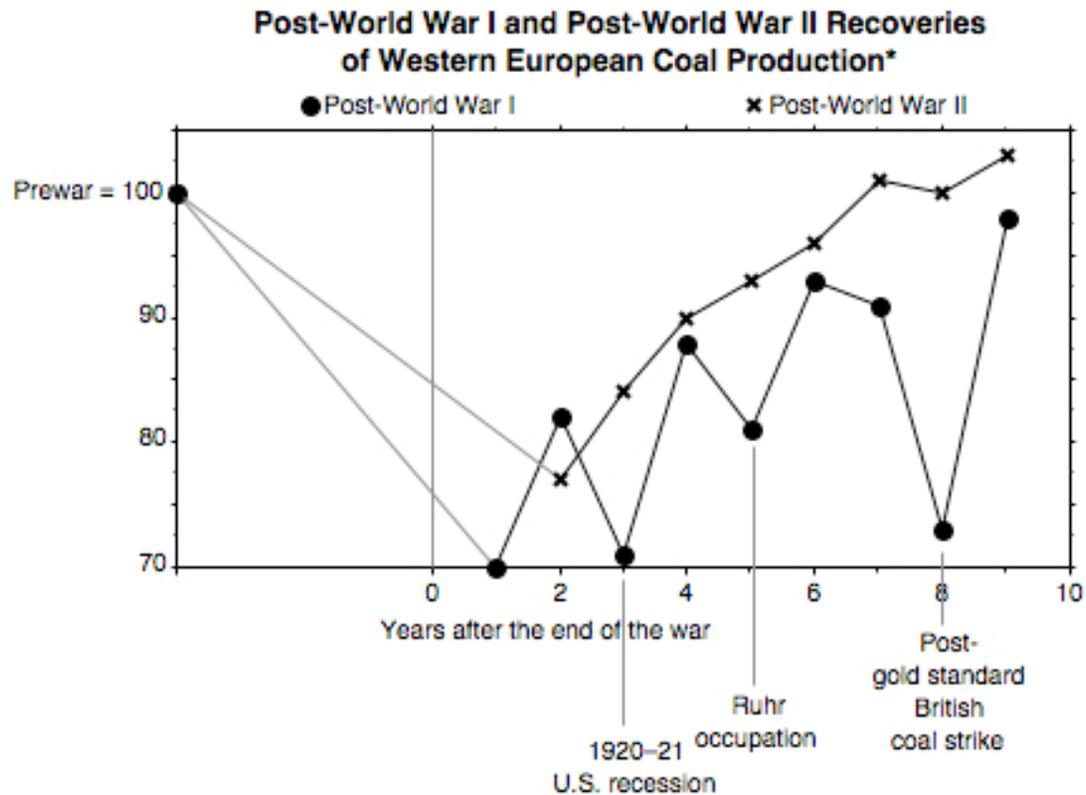


- Everybody is fine...
- H1N1
- Regulation

When Approaching a Stop Light, It Is Best to...

- A. Talk loudly on your cell phone while gesticulating with both hands off the wheel...**
- B. Change stations on the radio...**
- C. Text-message your friends from your “blackberry device”...**
- D. Gently brake while keeping both hands on the wheel and scanning your surroundings...**

Post-WWI and Post-WWII European Reconstruction Compared: A Graph



European Reconstruction Compared: Interpretation

- By 1950—five years after the end of the Second World War—Western European steel production had surpassed its prewar level. After World War I, in contrast, steel production did not exceed its 1913 level until nine years after the fighting ended.
- The recovery of coal production after World War II also outran its post-World War I pace by a substantial margin, even though coal was seen as in notoriously short supply in the post-World War II years. By contrast, the recovery of coal production after World War I was erratic.
 - Coal production declined from 1920 to 1921—falling from 83 percent of pre-World War I levels in 1920 to 72 percent in 1921—as a result of the deflation imposed on the European economy by central banks that sought the restoration of pre-World War I gold standard parities.
 - The breakdown of negotiations over German reparations led the French to occupy the Ruhr in 1923. Their occupation did not lead to significantly increased transfers from Germany to France. But it did begin the German hyperinflation.
 - Coal production fell for yet a third time in 1926. Attempts to reduce wages in the aftermath of Britain’s deflationary return to gold triggered a walkout by British coal miners, accompanied by a short-lived general strike. The 1920’s in Britain saw stubborn attachment by successive governments to a policy of a high real exchange rate and deflation, and an extraordinary degree of downward nominal wage inflexibility as well.
- The course of coal production shows that to a large extent the slow post-World War I recovery was inflicted by Europeans on themselves. The major factors hindering a rapid post-World War I recovery were not strictly economic but social and political.
- One interpretation is that post- World War I Europe saw the recovery of output repeatedly interrupted by political and economic “wars of attrition,” in the language of Alesina and Drazen (1991), that produced instability in European finance, politics, and labor relations.

Struggles Over Political Economy

- In the aftermath of World War I, all distribution of wealth issues were open:
 - the question of who would bear the burden of postwar adjustment.
 - the degree to which government would act to secure the property of the rentier.
 - the degree to which the government would attempt to guarantee high employment
 - the degree to which the government would provide “social insurance”
- All up for grabs Social classes, political factions, and nation-states saw that they had much to lose if they did not aggressively promote their claims for favorable redistribution.
- Much of the social and economic history of interwar Europe can be seen in terms of such “wars of attrition,” in which fiscal, financial, monetary, and labor relations instability—and concomitant slow economic growth—are trials of strength over who would succeed in obtaining a favorable redistribution of wealth.
- After World War II such “wars of attrition” were less virulent. Why?
 - Memories of the disastrous consequences of the aggressive pursuit of redistributive goals during the interwar period made moderation appear more attractive to all.
 - The fear of the Soviet Union,
 - The availability of Marshall Plan aid to nations that had accomplished stabilization provided a very strong incentive to compromise such distributive conflicts early, and gave European countries a pool of resources that could be used to cushion the wealth losses sustained in restructuring.
- Thus post-World War II reconstruction did more than return Western Europe to its previous growth path. Growth during the post-World War II boom raised national product per capita at rates that far exceeded pre-World War II, pre-1929, or even pre-1913 trends.
- There is no strong connection after WWII between the fall in levels of production across the wartime period and the pace of the subsequent recovery.

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“Supergrowth” Was Not Inevitable

- Traditional argument: Marshall Plan and “bottlenecks”... relaxing foreign exchange constraints.
- Marshall Plan funds were hard currency in a dollar-scarce world. They might have allowed Europe to obtain imports that that would relieve bottlenecks. After the war, coal, cotton, petroleum, and other materials were in short supply. The Marshall Plan allowed them to be purchased at a higher rate than would have been possible otherwise...
- But in a well-functioning market economy, it is difficult to argue that such bottlenecks had more than a transient impact on the level of production. The European economy was not without possibilities for substitution. Market economies are very good at finding and utilizing such possibilities.
- But would the market economy have been allowed to do its job?
- A very live possibility in the absence of the Marshall Plan was that governments would not stand aside and allow the market system to do its job.
- In the wake of the Great Depression, many still recalled the disastrous outcome of the laissez-faire policies then in effect. Politicians were predisposed toward intervention and regulation.
- No matter how damaging “government failure” might be to the economy, it had to be better than the “market failure” of the Depression.
- The example of the Soviet Union.
- Had European political economy taken a different turn, post-World War II European recovery might have been stagnant. Governments might have been slow to dismantle wartime allocation controls, and so have severely constrained the market mechanism. In fact the Marshall Plan era saw a rapid dismantling of controls...

Western Europe in the Argentine mirror...

- From the perspective of 1947, the political economy of Western Europe would lead one to think that it was at least as vulnerable as Argentina to economic stagnation induced by populist or authoritarian or nationalist or socialist or communist overregulation.
- The war had given Europe more experience than Argentina with economic planning and rationing.
- Militant urban working classes calling for wealth redistribution voted in such numbers as to make Communists plausibly part of a permanent ruling political coalition in France and Italy.
- Economic nationalism had been nurtured by a decade and a half of Depression, autarky and war.
- European political parties had been divided substantially along economic class lines for a generation.
- Yet Europe avoided this trap.
- After World War II Western Europe's mixed economies built substantial redistributive systems, but they were built on top of and not as replacements for market allocations of goods and factors.
- Just as post-World War II Western Europe saw the avoidance of the political-economic "wars of attrition" that had put a brake on post-World War I European recovery, so post-World War II Western Europe avoided the tight web of controls that kept post-World War II Argentina from being able to adjust and grow.
- Did the Marshall Plan play a role in Western Europe's successful avoidance of these traps?
 - restoration of financial stability;

- restoring the free play of market forces;
- negotiation of the “social contract” upon which supergrowth was based...

The Restoration of Financial Stability

- The neoliberal, market-oriented solution to the crisis was straightforward:
 - Prices had to be decontrolled to coax producers to bring their goods to market.
 - Inflation had to be halted for the price mechanism to operate smoothly and to encourage saving.
 - Budgets had to be balanced to remove inflationary pressure.
 - Without financial stability, the allocative mechanisms of the market could not be relied on
 - And government controls over the process of goods allocation would appear the more attractive option.
- For budgets to be balanced and inflation to be halted, however, political compromise was required.
 - Consumers had to accept higher posted prices for foodstuffs and necessities.
 - Workers had to moderate their demands for higher wages.
 - Owners had to moderate demands for profits.
 - Taxpayers had to shoulder additional liabilities.
 - Recipients of social services had to accept limits on safety nets.
 - Rentiers had to accept that the war had destroyed their wealth.
 - There had to be broad agreement on a “fair” distribution of income, or at least on a distribution of the burdens that was not so unfair as to be intolerable.
- Only then could pressure on central banks to continually monetize budget deficits and cause either explicit or repressed inflation be removed.
- Here the Marshall Plan may have played a critical role. It did not obviate the need for sacrifice. But it increased the size of the pie and reduced the costs of compromise relative to the benefits...

Restoring the Free Play of Market Forces

- Along with the carrot of Marshall Plan grants, the U.S. also wielded a stick: counterpart funds.
- Vincent Auriol claims that the U.S. refused to release French counterpart funds in 1948 until the new government affirmed its willingness to continue policies leading to a balanced budget. French officials were outraged: nevertheless, they took steps to obtain release and raised taxes.
- Marshall and Lucius Clay, Military Governor of the American zone, viewed with alarm British schemes for unifying and nationalizing the coal industries of the Ruhr, then part of the British zone of occupation: the United States was not interested in having Marshall Plan aid support policies of nationalization.
- The U.S. put pressure on Britain's Labour government to shrink its own nationalization programs.
- The Marshall Plan—specifically, the conditions attached to U.S. aid—left Western Europeans with no choice. Each recipient had to sign a bilateral pact with the United States. Europe was committed to the mixed economy. But the U.S. insisted that market forces be represented more liberally in the mix.
- The demand that European governments trust the market came from the highest levels of the Marshall Plan administration. Dean Acheson describes the head administrator, Economic Cooperation Administration chief Paul Hoffman, as an “economic Savonarola.” Acheson describes watching Hoffman “preach...his doctrine of salvation by exports alone” to British Foreign Secretary Ernest Bevin. “I have heard it said,” wrote Acheson, “that Paul Hoffman... missed his calling: that he should have been an evangelist. Both parts of the statement miss the mark. He did not miss his calling, and he was and is an evangelist.”
- European economic integration was pursued intensely by the Plan administration.
- It was not inevitable that Western Europe would have accepted the bargain.
- The magnitude of the “safety nets” and social insurance programs provided by the post-World War II welfare states were far beyond anything that had been thought possible before World War I. But these were accompanied by financial stability, and reliance on market processes for allocation and exchange.

The “Social Contract”

- The restoration of financial stability and the free play of market forces launched the European economy onto a two-decade long path of unprecedented rapid growth.
- European economic growth between 1953 and 1973 was twice as fast as for any comparable period before or since: GDP 2 percent per annum between 1870 and 1913, 2.5 percent per annum between 1922 and 1937, an astonishing 4.8 percent per year between 1953 and 1973, slowing to half that rate from 1973 to 1979.³⁸
- Europe’s rapid growth in the 1950’s and 1960’s was associated with exceptionally high investment rates.
- Accompanying high rates of investment was rapid growth of productivity.
- It would be tempting to ascribe Europe’s cyclical stability to the advent of Keynesian stabilization policy, but for the fact that Keynesian policy was not forgotten when increasingly volatile cyclical fluctuations recurred after 1972. A possible reconciliation is that Keynesian policy was effective only so long as labor markets were accommodating. So long as increased pressure of demand applied by governments in response to slowdowns produced additional output and employment rather than higher wages and hence higher prices, the macroeconomy was stable. Investment was maintained at high levels, and rapid growth persisted.
- The key to Europe’s rapid growth, from this perspective, was its relatively inflation-resistant labor markets. Why?
 - Kindleberger: elastic supplies of underemployed labor from rural sectors within the advanced countries and from Europe's southern and eastern fringe.
 - “History.” Memory of high unemployment and strife between the wars.
 - Bretton Woods System. Bretton Woods linked the dollar to gold at \$35 an ounce and other currencies to the dollar. So long as American policy makers’ commitment to the Bretton Woods

- parity remained firm, limits were placed on the extent of inflationary policies.
- A final potential explanation is the Marshall Plan.
 - Fear of the Soviet Union.

Thirty Glorious Years

- It is intriguing that, within the group of reconstructing nations, those where the United States had most leverage had the fastest-growing economies. United States influence was strongest in Germany, weaker in France and Italy, and weakest in Britain. In the post-World War II period the German economy was the most successful, the British economy least. Japan, where MacArthur was proconsul, is the exception that proves the rule.
- An “End of Ideology”
 - Stabilization policy
 - Progressive tax systems
 - Government-provided pensions
 - Health care
 - Unemployment insurance and other social services
 - Government-provided infrastructure
 - Government thumb in finance
 - Unions
- Market takes care of resource allocation...
- Government takes care of income distribution and opportunity...
- Regulatory state
- Bipartisanship
 - “Butskellism”: on this side of the Atlantic—John Connolly; Jamie Galbraith vs. Bruce Bartlett at

the JEC; Bartlett, me, McClellan, Rudd; Bernanke; Geithner.

Western Europe in the Argentine Mirror

