Slouching Towards Utopia?: An Economic History of the Long Twentieth Century

XIV. Thirty Glorious Years

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14.1. Refinding the Path Toward Utopia

1800-1870 saw invention and innovation in technology and organization open the door open to a better world, one in which humanity was not desperately poor under the harrow of Thomas Malthus's fears of limited resources, near-stagnant technology, and population pressure. 1870-1913 saw humanity walk through that door.

1914-1948 or so saw the door more than half-close. There was the Great Depression. And there was the destruction of World Wars I and II. There were the civil and revolutionary wars—the last of which, China's, did not come to an end until 1949. Growth in living standards over 1913-1938 was cut in half relative to 1870-1913, roughly back to or even below its 1800-1870 pace. Technology and organization were more used to kill and oppress than to free and enrich. Globalization went into reverse: countries raised barriers against imports to protect their own domestic producers. Wars sank ships. Wartime dislocations destroyed comparative advantages, and made investors and others wary of trying to construct new ones.

There was not that much ground for optimism in the immediate aftermath of World War II. Looking around at ideological challenges, at political mechanisms, and at dilemmas of growth and distribution

One, the greater, totalitarianism had been scotched—Nazi Germany. But another, if lesser, flavor—Stalin's and Mao's versions of really-existing socialism—were growing. They were materially weak, and poor. But they were populous. And they had a disturbing ability to get people to endorse and fight for their cause by telling implausible lies. Representative and parliamentary democracy looked in no better shape after World War II than it had been in 1914. The politicians who could rise in a system of representative democracy were those who told their slices of the electorate what it wanted to hear and delivered the goodies to rent-seeking interest groups: they were not the statesmen their countries needed. So it had been in the runups to World Wars I and II, in the aftermath of World War I, and in the Great Depression.

The way to bet seemed to be that global economy would continue to deliver political and economic dislocations, and people would continue to not be happy. A market economy could deliver progress and growth at the cost of frequent depressions and "creative destruction" that swept away all positions, privileges, and rights that were not backed up by valuable property rights. As Karl Polanyi had argued, societies did not like that. And their reaction had delivered the catastrophes of 1914-1948. Would things be any different looking forward from the end of World War II?

And yet the world picked up its mat and walked—nay, ran—forward towards true utopia.

From 1938 to 1973 measured economic growth in the future G-7 jerked forward: not at the 0.7%/year pace of 1913-1938 or even the 1.42%/year pace of 1870-1913, but at an average pace of 3.0%/year. That is a material-wealth doubling-time of not the 100 years or so of 1913-1938 or even the 50 years of 1870-1913, but 23 years: less than a generation. The G-7 was three times as well-off in 1973 as it had been in 1938. Japan grew at a previously unseen 4.7%/year—in spite of Curtis LeMay's firestorms and two atomic bombs that incinerated Japanese cities in 1944-1945. Canada and Italy grew at more than 3%/year. But they were not alone—Mexico and Spain as well as others achieved that rate of growth as well. The French call this period the Thirty Glorious Years: the *Trentes Glorieuses.*

14.2. Present at the Creation

Interwar and pre-World War I rich-country governments had been hobbled by their rejection of any mission to ensure general prosperity. That doctrine of *laissez-faire* had started out as a weapon to dismantle aristocratic mercantilism and then turned into a weapon to fight progressive taxes, social insurance programs, and "socialism" more generally. After World War II it had evaporated. The Great Depression had, in the United States at least, convinced the middle class that it had powerful interests in common with the working class—hence social insurance and macroeconomic stabilization at full employment were things demanded from all political parties that sought votes. And the totalitarian threat from Stalin's Soviet Union across the Iron Curtain created the North Atlantic alliance willing to follow America's lead.

So much good luck in one package was unexpected, and is still to marvel at.

14.2.1. The End of *Laissez-Faire*

14.2.1.1. Laissez-Faire as Simply "Stupid"

Laissez-faire had been the idea that the government should simply let the economy alone. The government should step back, limiting its economic role to the enforcement of contracts and protection of property rights. All beyond the duties of the "night-watchman state"—all beyond enforcement of contracts and protection of property rights—was "intervention" into the economy, and was guilty until proven innocent. Truth be told, *laissez-faire* was never economists' consensus: it was, rather, what other people thought and wrote that governments had applied and economists had taught. Nevertheless it had been a very powerful doctrine. But in the 1950s it was Republican American President Dwight Eisenhower who wrote, in a letter to his brother Edgar, that laissez-faire was dead, and that attempts to resurrect it were simply "stupid":

> The Federal government cannot avoid or escape responsibilities which the mass of the people firmly believe should be undertaken…. If a rule of reason is not applied… we will lose everything…. This is what I mean by my constant insistence upon "moderation"…. Should any political party attempt to abolish social security, unemployment insurance, and eliminate labor laws and farm programs, you would not hear of that party again…. There is a tiny splinter group…. Among them are H. L. Hunt… other Texas oil millionaires, and an occasional politician or business man…. Their number is negligible and they are stupid…

14.2.1.2. Ptolemaic "Saving the Phenomena"

There were those who claimed that the Great Depression did not demonstrate the *laiss*-faire was inadequate. They claimed, rather, that the Great Depression had been caused by government interference with the natural order. Milton Friedman, for example, claimed that the Great Depression had been caused by the Federal Reserve's failure to follow a "neutral" monetary policy. This struck me as positively Ptolemaic: saving the phenomena by redefining terms and adding complications rather than admitting that your approach had failed.

Milton Friedman eschewed fiscal policy as a stabilization tool, promising that a "neutral" monetary policy was simple to follow and would do the job. But the only definition of "neutral" monetary policy that could be made to work was this: a "neutral" monetary policy is one that stabilizes the economy. Follow your monetary policy. If it stabilizes the economy, then you know that it was "neutral". This is, to say the least, profoundly unhelpful to anyone making policy.

Yet behind the rhetoric at the bottom the message from Milton Friedman was the same as John Maynard Keynes was the same: a government that intervened on as large a scale to guide spending could guard the economy against Great Depressions without succumbing to the trap of socialist ideals leading to an over-mighty government that would in the end destroy political liberty and economic prosperity. It was just that Milton Friedman claimed that such intervention was not intervention at all.

14.2.2. Solidifying Keynesian Social Democracy

In the first post-World War II generation the Keynesian escape hatch provided governments, polities, and economies with what seemed like a miraculous solution to all the interwar dilemmas. It was no accident that U.S. Secretary of State Dean Acheson titled his memoirs *Present at the Creation*, for he and his peers truly had been present at the creation of an extraordinarily fruitful framework of political and economic institutions

So how did it happen that the first post-World War II generation of governments found their way to adopting the policies that led through the Keynesian escape hatch? And why was Keynes so right—why were his policy recommendations so apt for the post-World War II world?

14.2.2.1. Cementing Support for the Keynesian Order

A first, very important factor helping to make post-World War II economic reconstruction a success was the shadow of the past. Post-World War II reconstruction took place against the background catastrophe of World War II and of the preceding Great Depression.

The political and economic struggle between parties and classes in interwar Europe had ended in the mutual ruin of the contending parties. Right-wing factions had wanted low wages, no welfare state, stable prices (along with social order and nationalist self-assertion); left-wing factions had wanted high wages and an extensive welfare state. The far left had no tolerance for the near left. Mainline politicians in the interwar period, whether social democrats looking forward to the implementation of the socialist Gotha Program or Clause IV, or right-wing politicians interested in demolishing the embryonic welfare state and restoring traditional authorities, had looked forward to establishing their vision of the distribution of wealth and the role of the government by overrunning opposition—at the ballot box if possible, and through street violence and purges if necessary. The end of this political and economic struggle had been the rise of fascism and Nazism, which had benefitted no one.

The magnitude of Depression unemployment also shifted politicians', industrialists', and bankers' beliefs about the key goals of economic policy. Before the Depression a stable currency and exchange rate were key. But after the Depression even the bankers recognized that a high overall level of employment was more important than avoiding inflation: universal bankruptcy and mass unemployment were bad for workers, but they were worse for capitalists and bankers.

Thus entrepreneurs, the owners and managers of industry, and even the bankers found that they gained, not lost, from a commitment to maintain high employment first. High employment meant high capacity utilization. Rather than seeing tight labor markets erode profits by raising wages, owners saw high demand spread fixed costs out over more commodities and so increase profitability.

14.2.2.2. In America: Stabilization Policy

In America the consolidation of the mixed-economy Keynesian social-democratic order was straightforward. America had always been committed to a market economy. Yet it had also always been committed to a functional government. It had had a Progressive movement that had set out plans for the management of the market economy in the interests of equitable growth at the start of the 1900s. And it had the fortunate accident that the right-wing party was in power up until 1932 and hence were the bastards to be voted out. That made America's path relatively smooth. Roosevelt, and in 1945 upon Roosevelt's death Truman picked up the reins. The electorate ratified the New Deal order by giving Truman his own full term in 1948. And in 1953 Eisenhower saw his task as containing the further expansion of what he muttered under his breath was "collectivism" rather than as rollback.

The 1946 Employment Act declared that it was the "continuing policy and responsibility" of the federal government to:

> coordinate and utilize all its plans, functions, and resources... to foster and promote free competitive enterprise and the general welfare; conditions under which there will be afforded useful employment for those able, willing, and seeking to work; and to promote maximum employment, production, and purchasing power…

Laws that establish goals can and do serve as markers of changes in opinions, perceptions, and aims. Reference to "the law" use it as a shorthand marker to describe changes in hearts and minds. The largest shift in policy marked by the 1946 Employment Act is the post-World War practice of allowing the government's fiscal automatic stabilizers to function. For the past eighty-five years the federal government's budget slides into deeper deficit in recessions, and moves toward balance or into surplus when the economy expands. The gap between this calm acceptance of automatic stabilizers and cyclical fiscal deficits and pre-WWII attitudes is very large.

14.2.2.3. In America: Unions

The post-Great Depression settlement in the United States included a place for labor unions. In 1919, union membership in America was some 5 million. It fell to a trough of perhaps 3 million by Roosevelt's inauguration in 1933, grew to 9 million by the end of 1941, and took advantage of the tight labor market of World War II to grow to some 17 million or so by the inauguration of Eisenhower in 1953.

From 1933 to 1937 organizing unions became easier—in spite of high unemployment—because of the solid swing of the political system to the Democrats. The federal government was no longer an anti-, but a pro-union force.

The Wagner Act gave workers the right to engage in collective bargaining. A National Labor Relations Board monitored and greatly limited the ability of anti-union employers to punish union organizers and members, which the post-World War II Taft-Hartley Act did not reverse. Employers in large mass-production industries learned to value the mediation between bosses and employees that could be provided by unions. And workers learned to value the above-market wages a union shop could negotiate.

14.2.2.4: In America: Income Distribution:

Along with the 1930s rise and institutional entrenchment of the union movement there came the great compression of America's wages and salaries. In the late 1920s and 1930s, the top 10%, the top 1%, and the top 0.01% of the American population received 45%, 20%, and 3%. By the 1950s those shares were down to about 35%, 12%, and 1%, respectively. (By 2010 those shares would be up to 50%, 20%, and 5%.) To some degree this was because education had won its race with technology, temporarily making usually very poorly paid "unskilled" workers relatively scarce—and hence valued. To some degree this was the case because the closing down of immigration had similar effects on the supply of workers with no or shaky English. To some degree union threat and union power compressed the wage distribution. To some degree minimum wage and other regulations did the same. And to some degree the strongly progressive tax system instituted to fight World War II made attempts by the well-off to extract more wealth from the system at the expense of even a small amount of sand thrown into the gears of the economy unprofitable. If paying your CEO a much larger share of total production incites the ire of the union, it may not be worthwhile to try.

That this "great compression" is found all across the North Atlantic economies makes me tend to put more weight on the political-economic than on the supply-and-demand explanations. But perhaps different supply-and-demand explanations bore more of the load in different countries.

14.2.2.5. In America: Social Insurance

The third component of the post-World War II Keynesian settlement in the United States was the welfare, or social insurance, state. From a western European perspective the American social insurance state was anemic. A typical post-World War II British conservative like Margaret Thatcher found the absence of state-sponsored medical care in the United States appalling, and even barbarous. And in general means-tested programs for the poor also turned out to be significantly less generous in the United States than in western Europe: the American social insurance state did less leveling than did the European. Food stamps to subsidize diet, Aid to Families with Dependent Children to provide single mothers with some cash—but that program disappeared under President Clinton in 1994—and a small and rationed amount of low-quality public housing made up America's effort to give the poor additional purchasing power in the first post-World War II generation.

That the Great Depression was the major impetus for America's leftward shift from a *laissez-faire* to a more managed "mixed" economy had an impact on the form of the post-World War II welfare state. In Europe the mixed economy had a somewhat egalitarian bent: it was to level the income distribution, as well as insure citizens against the market. In America the major welfare state programs were sold as "insurance" in which individuals on average got what they paid for. They were not tools to shift the distribution of income. Social Security made payments proportional to earlier contributions. The pro-labor Wagner Act framework was of most use to relatively skilled and well-paid workers with secure job attachments who could use the legal machinery to share in their industries' profits. And the degree of progressiveness in the income tax was always limited.

14.2.2.5. In Western Europe: Balanced on the Edge

How is it that western Europe became more social democratic than the United States in the post-World War II period? Its internal politics had by and large swung to the right during the Great Depression. Its commitment to both political democracy and market institutions underpinning growing prosperity had been lesser than the United States for generations. And yet, somehow, in total Western Europe was more rather than less social democratic than the United States. When right-wing British politician Margaret Thatcher came to America in 1993, her conservative Republican-Party hosts expected her to denounced Democratic-Party plans for national health insurance as socialist overreach. She refused to do so, instead endorsing: "the principle that adequate health care should be provided for all, regardless of ability to pay".

14.2.3. Western Europe After World War II

14.2.3.1. The Immediate Aftermath

In the aftermath of World War II it was not clear that western Europe would utilize market mechanisms to coordinate economic activity. Belief in the market had been severely shaken by the Great Depression. Wartime controls and plans, while implemented as extraordinary measures for extraordinary times, had created a governmental habit of control and regulation. Seduced by the very high economic growth rates reported by Stalin's Soviet Union and awed by its war effort, many expected centrally-planned economies to reconstruct faster and grow more rapidly than market economies.

Memory of the Great Depression was fresh, and countries relying on the market were seen as likely to lapse into a period of underemployment and stagnation. A not uncommon judgment was that history was expected to dramatically reveal the superiority of central planning. In the words of Paul Sweezy:

> the socialist sector of the world would [after World War II] quickly stabilize itself and push forward to higher standards of living, while the imperialist sector would flounder in difficulties…

And British historian A.J.P. Taylor spoke in 1945 of how:

> nobody in Europe believes in the American way of life—that is, in private enterprise; or rather those who believe in it are a defeated party—a party which seems to have no more future…

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.

Europe after World War II was in worse economic shape than it had been after World War I. Another episode of financial and political chaos like that which had plagued the Continent following World War I appeared likely. 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.

14.2.3.2. Post-World War II Western Europe in a Latin American Mirror

There is an alternative scenario—an alternate universe—another branch on the universe's quantum wave function, overlapping ours in space and time yet as invisible to us in the sense that a radio tuned to 99.7 hears that only and is oblivious to 104.5—that saw the maintenance and expansion of wartime controls in order to guard against substantial shifts in income distribution. The late 1940s and early 1950s might have seen the creation in Western Europe of allocative bureaucracies to ration scarce foreign exchange. It might have seen the imposition of price controls on exportables in order to protect the living standards of urban working classes—as happened in various countries Latin America, which nearly stagnated in the two decades after World War II.

Consider Argentina. Before the war, Argentina had been as rich as Continental Europe. In 1913 Buenos Aires was among the top 20 cities of the world in telephones per capita. In 1929 Argentina had been perhaps fourth in density of motor vehicles per capita, with approximately the same number of vehicles per person as France or Germany. Argentina from 1870-1945 was a country in the same class as Canada or Australia. Yet after World War II, Argentina grew very much more slowly than France or Germany, rapidly falling from the ranks of the First World to the Third. Features of the international environment benefitting post-WWII Europe—the rapid growth of world trade under the Bretton Woods system, for example—offered the same potential benefits to post-World War II Argentina.

Might western Europe have followed a similar post-WWII trajectory? In Carlos Díaz-Alejandro's estimation, four factors set the stage for Argentina's relative decline: a politically-active and militant urban industrial working class, economic nationalism, sharp divisions between traditional elites and poorer strata, and a government used to exercising control over goods allocation that viewed the price system as a tool for redistributing wealth rather than for regulating the pattern of economic activity.

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.

Indeed, in 1946-7 U.S. State Department officials wondered whether Europe might be dying—like a wounded soldier who bleeds to death after the fighting. State Department memoranda presented an apocalyptic vision of a complete breakdown in Europe of the division of labor-between city and country, industry and agriculture, and between different industries themselves. 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 brutally along economic class lines for two generations.

Certainly after World War I western European growth had proceeded poorly—even more poorly than Argentinian growth after World War II. The recovery of coal production after World War I was erratic. Coal production declined from 1920 to 1921, falling to 72 percent of 1913's level as a result of the deflation imposed on the European economy by central banks that sought the restoration of pre-WWI gold standard parities. Coal production fell again in 1923-1924, when the French army occupied Germany's Ruhr valley because reparations were not being delivered fast enough. And coal production fell in 1925-26, when austerity's pressure to lower wages on Britain's coal producers, and triggered first a coal and then a brief general strike.

Post-WWI Europe had seen the recovery of output repeatedly interrupted by political and economic "wars of attrition" between contending classes and interests. How could such class "wars of attrition" be avoided and political compromise attained. And if it had happened that such such class wars had once again become the rule rather than the exception after WWII, was it not likely that western Europe would vote to join Stalin's empire, and then not hold a real vote again for a long, long time?

14.2.3.3. Europe Reaches a Good Equilibrium

Yet Europe avoided these traps. By 1949 national income per capita in Britain, France, and Germany had recovered to within a hair of pre-war levels. By 1951, six years after the war and at the effective end of the Marshall Plan, national incomes per capita were more than 10 percent above pre-war levels. Measured by the yardstick of the admittedly imperfect national product estimates, the three major economies of Western Europe had achieved a degree of recovery that post-World War I Europe had not reached in the 11 years separating World War I from the Great Depression.

No central bank or government pursued monetary orthodoxy so aggressively to roll back price and wage increases and preserve the real wealth of rentiers. Struggles over the distribution of income and wealth in "wars of attrition" were less virulent, in large part because memories of the disastrous consequences of the aggressive pursuit of redistributional goals during the interwar period made moderation appear more attractive to all. French, Italian, Low Countries, and West German 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. "Supergrowth," Charles Kindleberger has termed it.

Western Europe's mixed economies built substantial redistributional systems. But they built these systems on top of and not as replacements for market allocations of goods and factors. Though there was support for the restoration of a market economy in Western Europe, it was far from universal. Wartime controls were viewed as exceptional policies for exceptional times, but it was not clear what was to replace them. Communist and some Socialist ministers opposed a return to the market. It was not clear when, or even if, the transition would take place. Yet it did.

Post-World War II Europe was very far indeed from *laissez faire*. Government ownership of utilities and heavy industry was substantial. Government redistributions of income were large. 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 large welfare states were accompanied by financial stability, and by substantial reliance on market processes for allocation and exchange.

14.3. The Marshall Plan

14.3.1. The Marshall Plan

Why did things go so well for western Europe after World War II?

It is easy to reach the conclusion that western Europe's success was due to the U.S. administrations of Franklin D. Roosevelt and Harry S Truman. Hobbled inside the United States by a sometimes recalcitrant congress, the U.S. executive from 1945-1952 somewhat strangely found itself with more power outside. First, it ran the occupations of Japan and the bulk of west Germany. Post-World War II relief, offers of military cooperation and support against potential Soviet expansion, large-scale loans, and access to U.S. markets for European exports were all made available to western European countries that shaped their post-World War II policies in ways that gave the U.S. administration confidence.

Within two years after the end of the war it became U.S. policy to build up Western Europe politically, economically, and militarily. The Truman Doctrine inaugurated the policy of "containment" of the Soviet Union. Included was a declaration that containment required steps to quickly regenerate economic prosperity in Western Europe. And as columnist Richard Strout wrote, "one way of combating Communism is to give western Europe a full dinner pail."

Employing Secretary of State George C. Marshall's reputation as the architect of military victory in World War II, conservative fears of the further extension of Stalin's empire, and a political alliance with influential Republican Senator Arthur Vandenberg, Truman and his administration outflanked isolationist and anti-spending opposition and maneuvered the Truman Doctrine, the Marshall Plan, and then NATO for the defense of Europe through Congress.

Why was the plan named not for the U.S. president, Harry S Truman, but for his Secretary of State George C. Marshall. Why named after a Secretary of State? Truman put it best: "Can you imagine [the plan's] chances of passage in an election year in a Republican [majority] congress if it is named for Truman and not Marshall?"

14.3.2. Direct Effects

The Marshall Plan was a large multi-year commitment. From 1948 to 1951, the U.S. contributed $13.2 billion to European recovery. $3.2 billion went to the United Kingdom, $2.7 billion to France, $1.5 billion to Italy, and $1.4 billion to the Western-occupied zones of Germany that would become the post-World War II *Bundesrepublik*. Figure 1% of United States national income as a flow. Figure 3% of western European national income.

Marshall Plan dollars did affect the level of investment: countries that received large amounts of Marshall Plan aid invested more. Eichengreen and Uzan calculate that out of each dollar of Marshall Plan aid some 65 cents went to increased consumption and 35 cents to increased investment. The returns to new investment were high: an extra dollar of investment raised national product by 50 cents in the subsequent year. Another channel through which Marshall Plan aid stimulated growth was by relaxing foreign exchange constraints. Marshall Plan funds were hard currency in a dollar-scarce world. After the war, coal, cotton, petroleum, and other materials were in short supply.

But these direct effects are small potatoes. Marshall Plan aid plausibly boosted investment by only 1%-point of GDP. Even if concentrated on relieving the tightest bottleneck, such a commitment over three years can hardly be thought to have boosted western European's productive potential by more than 1%. Yet western Europe's post-WWII growth exceeded expectations by at least ten times that, and did so for three decades in a row.

14.3.3. Indirect Effects

Perhaps it was the political-economic effects that were dominant. Marshall Plan aid was preconditioned on successful financial stabilization. Each recipient had to sign a bilateral pact with the United States. Countries had to agree to balance government budgets, restore internal financial stability, and stabilize exchange rates at realistic levels. Internal price stabilization after World War II followed shortly after the announcement of the Marshall Plan, and in total took four years, the German hyperinflation took place in the sixth year after the end of World War I, and France's post-World War I inflation lasted for eight years.

Financial stabilization required balanced budgets. Balanced budgets required successful resolution of distributional conflicts. Here the Marshall Plan provided a very strong incentive. It gave European countries a pool of resources that could be used to cushion the wealth losses sustained in restructuring, and to sooth disappointed expectations from groups of labor and capitalists and landlords who thought they were not getting their proper shares of the pie. Marshall Plan administrators with one hand pressured European governments and interest groups to compromise, and furthermore to decontrol and liberalize their economies in a more "American" mold even when they wished to do otherwise. With the other hand they offered resources.

The resources did not obviate the need for sacrifice. But it increased the size of the pie available for division among interest groups. 3%—Marshall Plan aid as a share of recipient GDP—was not an overwhelmingly large change in the size of the pie. But if the sum of notional demands by interest groups that thought they were not getting their fair share happened to exceed aggregate supply by 6% percent, Marshall Plan transfers could reduce the sacrifices required of competing distributional interests by a half.

Perhaps a sizeable part of the credit for Europe's successful post-WWII reconstruction belongs to acts of statesmanship: the Marshall Plan and other initiatives that sped Western European growth by altering the environment in which political and economic policy was made. The Marshall Plan era saw the creation of the social-democratic "mixed economy": the restoration of price freedom and exchange rate stability, and the reliance on market forces within a context of a large social insurance state, some public ownership of industry and utilities, and a great deal of public demand management.

14.3.4. The Western Alliance

There was one additional very important factor making for post-World War II social democracy: the totalitarian threat from Stalin's Soviet Union across the Iron Curtain. Western Europeans feared this greatly. They wanted America in Europe to deter. Hence they created the North Atlantic alliance by their willingness to follow America's lead, and to drag America into leadership if necessary. What America wanted, they were eager to provide.

There is a story that when European leader Paul-Henri Spaak was asked if it wouldn't be a good idea to set up a bunch of statues to the founders of the European Union, he answered: What a wonderful idea! We should erect a 50-foot tall statue in front of the Berlaymont! Of Joseph Stalin!

It was the Group of Soviet forces in Germany and the presence of the tanks of the Red Army at the Fulda Gap that most concentrated everyone's mind on how much they wanted NATO, the Coal and Steel Community, the European Economic Community and then the European Union to succeed.

14.4. "Supergrowth"

14.4.1. Western Europe's Post-WWII Generation

Boom in the 1950s and 1960s the western European economies certainly did. Even the most casual glance at numbers and growth rates reveals that growth and recovery after World War II was astonishingly rapid. Considering the three largest Western European economies—Britain, France, and Germany—the Second World War inflicted much more damage and destruction on a much wider area than the First. And (except for France) manpower losses were greater in World War II as well. The war ended with 24 percent of Germans born in 1924 dead or missing, and 31 percent disabled; post-war Germany contained 26 percent more women than men.

14.4.1.1. The Pace of Recovery

Yet the pace of post-World War II recovery soon surpassed that seen after World War I. By 1949 average GNP per capita in the three large countries had recovered to within a hair of its pre-war level, and in comparative terms recovery was two years ahead of its post-World War I pace. By 1951, six years after the war, GNP per capita was more than ten percent above its pre-war level, a degree of recovery that post-World War I Europe did not reach in the eleven post-World War I years before the Great Depression began. What post-World War II Europe accomplished in six years had taken post-World War I Europe sixteen.

The restoration of financial stability and the free play of market forces launched the European economy onto a more-than-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. The growth rate of GDP was 2 percent per annum between 1870 and 1913 and 2.5 percent per annum between 1922 and 1937. In contrast, growth accelerated to an astonishing 4.8 percent per year between 1953 and 1973, before slowing to half that rate from 1973 to 1979.

Moreover, the post-World War II recovery did more than just rapidly restore Western Europe to its previous peacetime long-run growth path. French and German growth during the long-post World War II boom carried total production per capita to levels that far outstripped their economies' pre-1929 or even pre-1913 growth trends. In both France and West Germany labor productivity had outstripped their pre-1913 trends by 1955, and thereafter saw no noticeable slackening of growth. The dynamic of western European growth after World War II is an order of magnitude stronger than had hitherto been seen.

14.4.1.2. The Moderation of Europe's Business Cycle

Europe's rapid growth in the 1950's and 1960's was associated with exceptionally high investment rates. The investment share of GNP was nearly twice as high as it had been in the last decade before World War II or was again to be after 1972. Accompanying high rates of investment was rapid growth of productivity. Even in Britain, the laggard, productivity growth rose sharply between 1924-37 and 1951-73, from 1 to 2.4 percent per annum. This high investment share did not, however, reflect unusual investment behavior during expansion phases of the business cycle. Rather, it reflected the tendency of investment to collapse during cyclical contractions and the absence of significant cyclical downturns between 1950 and 1971—and after 1973,.

Since most post-World War II recessions—on both sides of the Atlantic—have been generated by central banks fearing that rising wages and prices will set off a destructive inflationary spiral (or responding too late to such a spiral already in progress), one place to look to understand the absence of European recessions between 1950 and 1971 is at the labor market. What created such "labor peace," such a combination of full employment with very little upward pressure on wages in excess of productivity gains?

A conventional explanation, following Kindleberger, is elastic supplies of underemployed labor from rural sectors within the advanced countries and from Europe's southern and eastern fringe. Elastic supplies of labor disciplined potentially militant labor unions.

Another explanation is "History." Memory of high unemployment and strife between the wars served to moderate labor-market conflict. Conservatives could recall that attempts to roll back interwar welfare states had led to polarization, destabilizing representative institutions and setting the stage for fascism. Left-wingers could recall the other side of the same story. Both could reflect on the stagnation of the interwar period and blame it on political deadlock. With a labor movement—and management organizations—more interested in raising productivity rather than in redistributing income, better strategy seemed to be to push for productivity improvements first and defer redistributions to later.

14.4.2. Global Bretton Woods

14.4.2.1. Building the International Monetary System

International monetary disorder—financial crises, devaluations, hyperinflations, trade restrictions for balance-of-payments reasons—had been a principal obstacle to recovery after World War I. The international monetary system has relatively little role in the history-of-events of the generation after World War II because not much went wrong: another example of the principle that "happy is the land that has no history."

When the delegations—the American delegation headed by Treasury Assistant Secretary Harry Dexter White, the British delegation headed by John Maynard Keynes, and the other delegations—met in the somewhat faded and substantially under-plumbinged mountain resort of Bretton Woods, New Hampshire, to build a post-WWII international monetary system, their minds were focused on what they saw as the lessons of the interwar period.

Keynes and White drew somewhat different lessons from the interwar period.

Keynes looked forward to a world in which countries could change their exchange rate parities relatively freely, and foresaw the application of trade and exchange restrictions in order to keep the requirements of the balance of payments from interfering with the pursuit of full employment. He looked to an International Monetary Fund that would provide extensive balance-of-payments financing ("subject to increasingly demanding conditionality and penalty interest rates" imposed on both trade-surplus and trade-deficit countries).

White, by contrast looked forward to a world of free capital flows and fixed and rarely-adjusted exchange rates. In White's conception, countries would be allowed to change their exchange rates only if the IMF permitted it.

The Bretton Woods system that they wound up constructing departed from the gold standard in three interlinked ways:

1. Exchange rates were fixed and pegged, but the pegs were adjustable in response to "fundamental disequilibrium." The idea was to avoid a situation like that of Britain in the late 1920s, when either devaluation or deflation is called for, and adherence to the rules of the game of the gold standard would force deflation and a prolonged depression.
2. Countries were allowed to adjust their currencies by up to ten percent—after consulting with the IMF—in cases of "fundamental disequilibrium," although larger changes were supposed to wait upon formal IMF approval.
3. Controls on international capital flows were explicitly allowed: Keynes and White had no desire to see international speculators move exchange rates and upset governments' policies.

14.4.2.2: The International Monetary Fund

The International Monetary Fund was established to be a referee. Countries were supposed to maintain fixed exchange rate parities vis-a-vis one another. But when one country ran a persistent balance of payments deficit that threatened to exhaust its reserves, it could borrow from the IMF. The IMF would extend financial support to countries that needed more reserves to ride out a temporary balance-of-payments deficit. But the IMF would also be the judge of whether "fundamental disequilibrium" existed—and thus of whether exchange rate pegs should be changed, and whether policies or the level of the exchange rate needed to be changed to restore balance.

The Bretton Woods pegged the dollar to gold at $35 a (troy) ounce, and pegged other currencies to the dollar. As long as American policy makers' commitment to the Bretton Woods parity remained firm, limits were placed on the extent of inflationary policies. As long as European policy makers were loath to devalue against the dollar, limits were placed on their policies as well. Price expectations were stabilized. Inflation, where it surfaced, was more likely to be regarded as transitory. Consequently, increased pressure of demand was less likely to translate into higher prices than into higher output, and higher employment—as long as the system held.

The system held—barely. The Bretton Woods system did not work as designed. Even from the beginning the idea of an adjustable peg proved to be, as Eichengreen puts it, an "oxymoron." Moreover, the IMF's ability to oversee what was going on and to pressure countries to adopt system-stabilizing policies soon proved very limited. And the IMF's resources were always much too small.

14.4.2.3: The United States as Sea Anchor

It may have been the United States as stable sea-anchor that made the difference. It was the key country. Had it turned deflationary, then the fixed-parity rules of the Bretton Woods system would oblige other countries to turn deflationary as well. Had it turned inflationary, then the fixed-parity rules of the Bretton Woods system would oblige other countries to turn inflationary as well. The fact that other countries pegged their currencies in terms of the dollar meant that there was no substitute for stability at the core. Fortunately, for the first post-World War II generation—up until 1970, say—American economic policy produced a reasonably stable economy. With the exception of the shock of the Korean War, inflation was low. Fluctuations in unemployment were kept within moderate bounds.

To a substantial degree, this was because all parties and economists were terrified lest the Great Depression return. To fight off this possibility, politicians and economists paid very close attention to the lessons of the Great Depression and of the New Deal, which were seen as roughly three: (1) unemployment is the disease; (2) high demand is the medicine; (3) the federal government—though loose monetary policy and deficit spending—is the doctor.

Was the relative stability of the American economy up until 1970 more than simply a matter of good luck? The only answer I can give is a firm "maybe." Recessions became rarer (although not shorter). Overwhelmingly compared to the 1916-45 ("interwar") period, and substantially compared to the 1886-1915 ("prewar") period, there was a reduction in the share of the time that the economy has spent in recession.

But the major improvement in performance stemmed from the fact that the post-World War II era saw no repetition of anything like the Great Depression of the 1930s—until 2008.

14.5. Technology, Trade, and Organization

14.5.1. Freer Trade

The General Agreement on Tariffs and Trade was a stopgap that grew up when the institution envisioned at Bretton Woods, the International Trade Organization, failed to be born, was. It established general rules-multilateralism and non-discrimination-that meant that trade liberalization for one would become trade liberalization for all. It established, for the first time in histlory, an ongoing institution dedicated to the reduction of barriers to trade throughout the world.

It was very successful.

The average tariff imposed by the United States declined by nearly 11/12 over the 33 years from the Geneva Round of 1947 to the Tokyo Round of 1974-79. From 1953 to 1973, world real GNP grew at an average rate of 4.7 percent, and world trade at a rate of 7.5 percent per year.

The pattern of world trade that developed after World War II was curious. David Ricardo's original analysis of the economic of world trade

The post-World War II industrial world was populated by a large number of firms making differentiated products, and then selling these products worldwide. The added scope of the market allowed for a greater division of labor, and here—in consumers' choice certainly, and in productivity possibly—was a major gain from trade. World trade became not the exchange of coffee for washing machines, but the exchange of small cars for large cars, or of high-priced silks for moderate-priced synthetics.

14.5.2. Technological Diffusion

As the first post-World War II generation turned into the second, and as industries in the industrial core became more and more mechanized—more and more characterized by "mass production"—they should have become more and more vulnerable to foreign competition from other, lower wage countries. If Ford could redesign production so that unskilled assembly line workers do what skilled craftsmen used to do, why couldn't Ford also-or someone else-redesign production so that it could be carried out by low wage Peruvians or Poles or Kenyans rather than by Americans, who are extraordinarily expensive labor by world standards?

Industries did migrate from the rich industrial core to the poor periphery. But in the first post-WWII generation or two they did so surprisingly slowly. One reason was added risk: political risk of all kinds tends to make investors wary of committing their money in places where it is easy to imagine political disruptions from the left or the right. Moreover, there were substantial advantages for a firm in keeping production in the industrial core, near to other machines and near other factories making similar products. It was much easier to keep the machines running. A reliable electric power grid was much more likely to be found in the industrial core. And so were the services of specialists needed to fix the many things that can go wrong-minimum efficient scale for an industrial civilization can be far larger than the apparent minimum efficient scale for a plant.

These factors were an order of magnitude more important for industries that are in technological flux than for those that have a settled, relatively unchanging technology. A principal advantage of locating near the firms that make your machines came from the interchange and feedback of users and producers-feedback that is valuable only if designs are still evolving. And the principal advantage of a machine-knowing and relatively well-educated labor force was the ability to adapt to using slightly different machines in somewhat different ways—once again, valuable only if small changes are constantly being made.

As industries reached technological maturity, freeze their production processes into set patterns, and become businesses in which sales are made on the basis of the lowest price, they did tend to migrate to the periphery of the world economy: handed down to poorer countries as, in the words of a Japanese development advisor, older siblings hand down to younger ones clothes they no longer need.

And all this was to change later on, as the world economy entered the post-1990 age of value chains.