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PERSPECTIVE: The Marshall Plan and Industrial Policy

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club. This underscores the importance of educating dislocated workers about labor market trends.

The White House initiative

The success of the Crucible job-search club, as well as of efforts in Detroit (the Downriver project), California, and elsewhere has drawn much interest. The Advisory Council on Private Sector Initiatives was sufficiently impressed to push the idea into center stage. With funding from the Commerce and Labor Departments, the Council is sponsoring the creation of additional prototype job-search clubs across the country. The prototypes are to demonstrate how effective the clubs can be for dislocated workers, especially when jointly sponsored and managed by local companies and unions. By implication, the prototypes are highlighting the kind of effort the private sector itself can undertake as well as a desirable use of Title III JTPA funds.

The risks and rewards

There is every reason to believe that the new job-search clubs will

be successful. The low cost of providing assistance for the search (roughly \$300 to \$400 per participant) virtually assures their cost-effectiveness. Indeed, the Congressional Budget Office has singled out job-search clubs as potentially the most cost-effective service to dislocated workers.

For all their virtues, however, job-search clubs carry certain risks. The greatest is that they will be too quickly embraced as "the" solution to unemployment. They cannot be, of course, but politics and deficits may combine with cost-effectiveness to render the clubs a substitute for other needed employment and training services. They may also serve as a scapegoat for more expansionary policies.

There are also basic questions of equity. The new emphasis on dislocated workers may force further cutbacks in services to the disadvantaged. In fact, the very success of job-search clubs in finding jobs for dislocated workers may diminish opportunities for other unemployed workers.

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ic conditions conducive to investment and growth. Beyond this critique, however, it is unclear what mix of macroeconomic policies is favored.

This gap in industrial policy literature is both surprising and disturbing. Surprising, in that the nations often cited as successful exponents of industrial policy, notably France, Germany, and Japan, have long recognized that micro- and macroeconomic policies must be complementary. Disturbing, in that an industrial policy cannot be effectively carried out without a more rigorous view of the macroeconomic policies that would be appropriate.

A famous case of industrial policy, the Marshall Plan, demonstrates that European recovery was achieved not merely by the injection of dollars into specific industries, but also by the creation of monetary and fiscal policies in Europe that ended the wartime legacy of inflation. The recognition that postwar reconstruction depended on both micro- and macroeconomic policies should contribute to today's debate about the role of government in economic revitalization.

The ideas behind the Plan

Secretary of State George Marshall offered American assistance for European recovery on June 5, 1947 because he believed that without a large-scale program, Europe would forever rely on piecemeal grants and credits. From 1945 to 1947, recovery's progress had been fitful, and it seemed to the American people that the various ad hoc aid measures—the British loan, the U.N. Relief and Rehabilitation Administration—had been wasted. Marshall sensed that Congress was growing impatient with requests for a billion here, a billion there.

Of course, one problem with American foreign economic policy

PERSPECTIVE

The Marshall Plan and Industrial Policy

One by-product of a decade of economic decline has been an outpouring of literature on industrial policy. While the concept remains fuzzy, industrial policy refers to a rational plan for government intervention at the microeconomic level. Specific components of an industrial policy may include sectoral intervention, protectionism, adjustment assistance, the creation of

risk-taking banks, and support for research and development; the objective is to ensure the economic competitiveness of key industries.

Supporters of industrial policy take a malign view of macroeconomic management. America's dismal performance in the 1970s and early 1980s, it is said, demonstrates that fiscal and monetary policies cannot ensure the econom-

at the war's end was that the prognosis for European recovery had been too optimistic. Policymakers believed that the World Bank and International Monetary Fund would be able to handle the job of reconstruction. It took time for Washington to understand the extent of economic dislocation.

To Europeans, the destruction was apparent. Britain emerged from the war with one-quarter of its 1938 wealth destroyed, and its current account deficit in 1946 stood at 370 million pounds sterling. On the Continent, life had sunk to a subsistence level. There were shortages of food and fuel, and millions were homeless. Production had fallen far below prewar levels. Pig iron output in 1946 was 19 million tons, half the 1939 volume. Steel production was 27 million tons against 52 million before the war. Coal production stood at 292 million tons, against a 1939 level of 500 million.

Less visible but equally pernicious was the monetary chaos. European treasuries had financed the war by running the printing press, and the result was rampant inflation. In Greece the money supply at liberation was ninety-six times the 1938 level; in Italy, forty-nine times. The money supply in France had grown tenfold during the conflict, and in Britain, Scandinavia, and the Netherlands it had doubled. Whether inflation was open or repressed, all European governments were faced with the problem of too much money chasing too few goods.

With little production and lots of cash, it was impossible for postwar Europe to avoid balance-of-payments difficulties. Despite import controls in most countries, goods and services reached Europe, and in 1947 it had a current account deficit of \$6.9 billion. Emergency assistance from America made good some of this amount, but the bulk was met by a deep plunge into

reserves of gold and dollars. During the frightful winter of 1946-47, foreign exchange reserves were so low that even imports of essential food and fuel were threatened.

In the spring of 1947, American officials began to consider the idea of a massive aid program designed to restore the European economy. Academic economists also offered prescriptions for European recovery in articles and books. A lively intellectual debate emerged concerning the reconstruction process. The debate suggests that unanimity was lacking both in regard to Europe's problems and to the appropriate solutions.

At the State Department, George Kennan's Policy Planning Staff suggested that "bottlenecks" were clogging the recovery. American aid should break those bottlenecks, it was believed, especially in the coal sector. The lack of coal made it impossible to produce steel and machinery and to generate electricity. If dollars were used to boost coal production, the benefits would be felt throughout the European economy.

Not all analysts supported such a focused attack. To Harvard's Seymour Harris, the major problem facing Europe was the dollar shortage, a condition in which Europe demanded more in imports from America than it could earn through exports. Because of this lopsided situation, Europe's balance of payments was in "fundamental disequilibrium," a chronic ailment that could not be cured by orthodox economics. Harris called for an aid program that would boost industrial productivity and develop crucial industries. During the recovery period, he proposed, exceptional economic controls should be used to ensure that imports be limited to essentials. Further, Harris said that Americans must accept discriminatory tariffs and other barriers to free trade.

The notion of a "dollar shortage" was appealing to many but not all economists. Harris' colleague Gottfried Haberler was a leading skeptic, and in one piece he wryly commented that most Americans, in addition to the Europeans, could purchase less than they wanted and thus suffered a dollar gap themselves. Haberler disagreed that Europe's balance of payments was in fundamental disequilibrium; he said that chronic deficits were a result of high levels of inflation, rather than an inability to find markets for European products. Recovery in Europe, Haberler believed, depended on the ability of governments to push through necessary monetary and financial reforms. Beyond that, investment was clearly needed, but it should be directed at working capital—repairs to the infrastructure, additions to inventories, and the like—rather than at large projects with a distant payback.

Marshall's speech at Harvard on June 5 incorporated all of these views, with a few more besides. He said that the "entire fabric" of the European economy had been dislocated by the war. Recovery depended not only on American assistance, but on European cooperation as well, he declared; America was prepared to offer aid to *all* European nations that would agree to a joint recovery plan. The purpose of this plan must be nothing less than "the revival of a working economy. . . ."

How the money was disbursed

In the days following Marshall's speech, a number of European nations, including the Soviet Union, agreed to meet to discuss the Secretary's offer. Ultimately, Stalin withdrew from the talks, and the sixteen remaining nations founded the Committee of European Eco-

nomic Cooperation (CEEC). In September 1947, the CEEC presented a four-year reconstruction plan to Washington.

The CEEC's estimates for dollar aid were based on Europe's projected current account deficit with the United States. From the standpoint of 1947, it appeared that American assistance over the next four years would have to total \$19 billion if the continent's vital needs were to be met. Of this amount, 38 percent would be used to purchase food and fertilizer, 36 percent for raw materials, 10 percent for coal and petroleum, and the remaining 16 percent for iron, steel, timber, machinery, and equipment.

American officials considered the deficit projection rather exaggerated. The Europeans, it appeared, had set unrealistic production and consumption goals, and bottlenecks in the availability of petroleum, steel, and other commodities were unrecognized. The CEEC estimates were therefore trimmed, with the current account deficit to be financed placed at between \$12.5-\$17.2 billion.

While these first efforts at planning were useful, the actual European Recovery Program (ERP) launched by Congress in April 1948 rejected the comprehensive, four-year approach. Instead, funds were appropriated yearly, based on Europe's projected needs. Further, the ERP would not be administered by the State Department, but by an Economic Cooperation Administration (ECA) established for the purpose. The head of ECA was Paul Hoffman, President of the Studebaker Corporation, and Congress was determined to see ECA staffed by businessmen rather than bureaucrats.

The ECA allocated dollars for European imports on the basis of requests made by the CEEC on behalf of the participating countries. These requests could be approved,

rejected, or amended, as the ECA saw fit. On both sides of the Atlantic, therefore, a large degree of government intervention was called for.

The United States was able to influence the European economies in other ways as well. In each participating country, "counterpart funds" were placed in the central bank. These funds were the local-currency equivalent of the country's Marshall Plan aid; their disbursement was made contingent on ECA approval.

The effects on imports and investment

Between 1948 and 1951, the sixteen European nations that participated in the Marshall Plan received over \$13 billion. Of this amount, 75 percent went to five nations: Britain (\$3.1 billion), France (\$2.7 billion), Italy (\$1.5 billion), Germany (\$1.4 billion), and the Netherlands (\$1 billion). During these years, per capita GNP in Europe rose by 33.5 percent, with especially notable gains in France, Germany, and Italy. The question that naturally arises is: what role did Marshall Plan funds play in the continent's remarkable postwar growth?

In fact, the question can be answered in several ways. One way is to assess the importance of American aid in financing "vital imports" from the United States. These imports included wheat, cotton, and crude and refined petroleum. ERP funds paid for between 24 and 62 percent of the five nations' imports of wheat, 13 and 54 percent of cotton, and 12 and 33 percent of petroleum. Clearly, the impact of the Marshall Plan here was significant.

These statistics, however, lead us to wonder why Europe was unable to obtain more from "non-dollar" countries, e.g. Common-

wealth nations that accepted sterling in payment for international transactions. The answer is complex. On the one hand, the war and its aftermath forced Europe to turn from traditional suppliers and toward the United States. Rumania, for example, had provided prewar Europe with 50 percent of its petroleum requirements, but this trade halted at the war's end. East-West economic relations in general were disrupted by the Cold War; indeed, various acts of legislation prevented Western Europe from conducting "normal" levels of trade with the Soviet bloc as a price for American aid. Further, during the war colonial powers such as Britain and France had been unable to invest in agricultural and raw materials production in their overseas territories, and thus in the late 1940s demand for primary products could not be met.

Beyond this, the Marshall Plan itself helped to establish a pattern of world trade that centered on the United States. So long as dollars were being provided for the purchase of American goods and services, the participating countries had little incentive to develop non-dollar suppliers. It can be argued that European nations would have found or created other sources for needed commodities had ERP aid not been available.

The vital-imports issue provides only one way of looking at the Marshall Plan. Perhaps a more illuminating view would focus on the ERP's role in European investment. The ECA, it will be recalled, had the final say on disposition of counterpart funds, which were one source of investment. A great deal of controversy was generated in Europe about the way in which these and other investment funds should be used.

A common postwar complaint, voiced by Roy Harrod, John Williams, and others, was that Europe-

Table 1

**ERP Funds as a Percentage of
Gross Investment in Fixed Capital
(in billions of dollars)**

	U.K.	France	Germany	Italy	Netherlands
(1) Gross investment in fixed capital ^a	21.5	14.5	17.6	9.25	4.65
(2) ERP country allocation	2.8	2.4	1.3	1.3	0.9
(3) ERP as % of (1)	13%	17%	7%	14%	21%

^a1948-1951.

Sources: Author's estimates, based on: United Nations, Economic Commission for Europe, *Economic Survey of Europe Since the War* (Geneva, 1953), and Economic Cooperation Administration, *Thirteenth Report to Congress* (Washington, Government Printing Office, 1951).

an governments were spending too much on large capital projects. Instead of satisfying immediate consumer demands, the lion's share of investment went to such basic industries as steel, chemicals, and public utilities. Twelve percent of counterpart-fund investment went to electric power projects, 8 percent to the transportation sector, 10 percent to mining (including coal and metals), and 8 percent to agriculture.

European governments focused on such projects for a variety of reasons. In France, planners invested in heavy industry because they believed that overall economic recovery rested on the fate of a few key sectors. In Britain, however, investments often went to coal and power simply because they were nationalized industries and had a large amount of political muscle. Indeed, despite efforts by some postwar British governments to trim investment in these areas, the political going was just too rough.

Yet all nations were concerned that large capital investment might prove inflationary. Italy and Germany resisted American prodding for higher levels of investment. The Italians were determined to found their recovery on solid monetary policies. The government saw a stable value for the lira as essential to the realization of its economic goals. Similarly, in Germany, mon-

etary reform proved crucial to the recovery effort.

European governments were prepared to argue with Washington about the direction of Marshall Plan funds because, in the final analysis, American aid was a marginal source of capital. As Tables 1 and 2 indicate, ERP funds as a percentage of Europe's gross investment in fixed capital was in the range of 7 to 21 percent, with Germany at the low end and the Netherlands at the top. The figures are even smaller in terms of European investment in machinery and vehicles.

The macroeconomic setting

The challenge that postwar European governments faced was to promote economic expansion in a non-

inflationary environment. Anti-inflation measures were not only crucial if governments were to win public confidence in the currency, but also in the battle to achieve balance-of-payments equilibrium. With high levels of inflation, demand for imports would remain strong while exporters would have difficulty competing. Notably, Europeans credited Belgium's relatively quick postwar recovery to its monetary reform and lowering of inflation. Observers also credited monetary reform in Germany as key to that nation's reconstruction. Even France, after 1951, took great strides in reducing inflation. As production increased and inflation fell, Europe was able to reduce its current account deficit from a 1947 level of \$6.9 billion to a 1950 level of \$500 million. While the Korean War and attendant price hikes for raw materials caused the 1951 deficit to surge to \$1.3 billion, from 1952 on the Marshall Plan countries enjoyed a current account surplus.

Of course, Europe's balance-of-payments difficulties were also righted by trade and currency controls, anathema to the postwar goal of a multilateral free-trade regime. These controls remained in place long after Europe surpassed prewar industrial production levels. But even here, the varieties of European experience must be kept in

Table 2

**ERP Funds as a Percentage of
Gross Investment in Machinery and Vehicles
(in millions of dollars)**

	U.K.	France	Germany	Italy	Netherlands
(1) Gross investment in machinery and vehicles	12,200	7,590	9,800	—	2,684
(2) ERP allocation for machinery and vehicles	291	530	39	279	171
(3) ERP as % of (1)	2%	6%	< 1%	—	6%

Sources: See Table 1.

mind. Indeed, the two nations that were at the forefront of lifting internal and external controls, Italy and Germany, also experienced the fastest rates of economic growth between 1950-1960.

European recovery depended, then, on new investment on the one hand and responsible monetary and fiscal policies on the other. Governments were largely successful in integrating micro- and macroeconomic concerns, and in so doing established the conditions necessary for a period of sustained growth. This historical record should lead industrial policymakers to reconsider their glib assessment of stabilization measures.

What is needed today is an industrial policy that addresses both micro and macro issues. It may be fine, for example, to suggest federal assistance to the semiconductor industry, but what good is such assistance if a strong dollar makes ex-

porting impossible? Likewise, there may be merit in the creation of risk-taking banks and the raising of government research and development expenditures. But what payback will these initiatives have if higher levels of government spending spur inflation or boost interest rates? These are rather basic questions to be asking in a serious economics publication. Unfortunately, would-be industrial policymakers have not been forthcoming with answers.

If industrial policy is to contribute to economic revitalization, therefore, it must be integrated with monetary and fiscal policies. Obviously, the formulation of such a policy presents a formidable challenge. Is it a greater challenge, however, than the one Europe's postwar planners faced?

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ANALYSIS

The Free Market Needs Help: Incomes Policy

In his article "Keynes' Policies in Theory and Practice" (*Challenge*, November/December 1983), James Tobin makes an eloquent plea for the third Keynesian policy instrument—an incomes policy. Unfortunately, Tobin, along with most other advocates of an incomes policy, weakens his case by overlooking an important argument in support of such an approach: a well-designed incomes policy can promote market efficiency and increase economic growth.

That conclusion may appear surprising. But it follows from a rela-

tively straightforward analysis of wage-setting in an industrial economy. The process by which wages are determined is not well captured in standard microeconomic theory, which provides little room for the complications introduced by a continuous employment relationship, costly information within the firm, and the importance workers assign to relative position.

The dual wage theory

In my new book (*The Price of Industrial Labor*, D.C. Heath, 1984),

I build an alternative theory of wages. It has three parts. First, custom and tradition are likely the least-cost guide to group behavior in the workplace. They also provide benchmarks against which workers can assess whether or not management behavior is fair. Simply put, in wage determination, behavior repeated often enough—for example, a yearly increase in real wages or an increase geared to that received by workers in another firm or industry—becomes the standard for acceptable behavior. Such standards of comparison are not carved in stone, but they can be quite costly to change. The existence of wage norms is consistent with even the most casual observation of labor market behavior.

Second, violations of established wage norms make workers angry. And they will seek redress if they can. Their ability to do so depends largely on two characteristics of the firm. (1) How costly is it to obtain information on workers' behavior on the job? High cost gives workers more leeway to vary their behavior and enforce their version of the employment contract. As a result, large establishments—where supervisors have supervisors—are more likely to practice wage-norm pricing. (2) What is the level of general or firm-specific human capital required in the production process? The more that is needed, the more vulnerable the firm is to collective worker action. Where a workforce is unionized, or there is a credible threat of unionization, formal collective labor action can enforce wage norms. No one with his or her eyes open will deny that strikes can hurt a firm a great deal.

Third, when the market-clearing wage is below its going rate, the rational firm will weigh the gains from a wage cut against the production losses that cut is expected to generate. There are predictable cir-