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THE MARSHALL PLAN AND EUROPEAN ECONOMIC POLICY

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In this, the ninth essay in the series published by the International Finance Section of the Department of Economics and Social Institutions in Princeton University, Professor Friedrich A. Lutz, whose essay on International Monetary Mechanisms inaugurated the series, returns to the list. The importance of the problem he here treats needs no emphasis.

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By FRIEDRICH A. LUTZ

I. INTRODUCTION

THE three aspects of the Marshall plan that have been most thoroughly discussed are (1) the estimates of the Paris conference on the expected deficit of the sixteen European nations with the American continent and the United States in particular, (2) the possible repercussions of the plan on the American economy, and (3) the method of administering foreign aid. A fourth aspect concerns the economic policy which the recipient countries should follow if the Marshall plan is to be a full success. Apart from a general statement that these countries should make every effort to balance their budgets and stop inflation, little has been said about this phase of the problem. In an endeavor to fill the gap the present essay deals with the principal implications of the plan for the economic policy of the recipient countries, and offers a short addendum on administration.

II. THE PURPOSE OF THE AMERICAN FOREIGN-AID PROGRAM

If the United States could freely choose the period in which to make foreign loans it would obviously be in the interest of the American economy to start, or increase, lending in times of a domestic depression and to stop, or retard, lending in times of a domestic boom. Such a foreign loan policy would, in a depression, keep employment above the level it would attain in the absence of the loans and, in a boom, would assuage inflationary tendencies.

The United States, however, is now called upon to lend or grant aid to foreign countries in a period of domestic boom characterized by strong inflationary forces. It is quite obvious that such lending is not in the *short-run* interest of the American economy. On the contrary, it is generally agreed that a large lending program at the present time may have three unpleasant economic consequences: 1) it will create acute shortages in some of the products which both this country and Europe most urgently need (scrap iron, steel, agricultural machinery, grains); 2) it will in all probability strengthen present inflationary tendencies; 3) it may lead to the reintroduction of controls for the purpose of allocating the scarce commodities between rival domestic

and foreign users and of preventing sharp price rises in such commodities.

Present inflationary tendencies will be strengthened for two reasons. First, the foreign lending may directly increase the aggregate monetary demand for commodities in the domestic market. Such an increase in the aggregate demand is not, indeed, a *necessary* consequence of the loans. Only if the funds are newly created by the banking system, or are released from hoards, does foreign aid directly increase aggregate expenditures in the American economy. But this is likely to happen unless strong efforts are made to prevent its occurrence. Secondly, and this is perhaps more important, foreign aid will affect certain prices much more than others. The commodities in very short supply, the prices of which will be most affected, occupy a strategic position in the American economy; in particular, steel, because it enters as a cost item into many manufactured products, and grains, because their prices are likely to affect, *via* the cost of living, the wage demands of workers. It is, therefore, likely that the potential sharp rise in the price of these commodities will promote an additional application for newly-created bank funds on the part of the business community and thus indirectly increase the aggregate monetary demand in the economy.*

If, from the standpoint of American economic interest, no advantages but only disadvantages from the plan can be expected in the short run, what are the benefits to be gained over a longer period? Some of the Government Reports, *e.g.* the report of the Economic Advisors to the President and the Harriman Report, express the fear that without such aid the European countries would be driven into ever more stringent devices of foreign trade control, and they voice the hope that the aid will enable these countries to develop their productive capacities and their exports so that, after a number of years, they will be in a position to drop foreign exchange control, at least for transactions on current account, and return to multilateral trade. Foreign aid, so far as the United States is concerned, is thus another milestone on the road the government has been traveling, a road that went from the Bretton Woods Agreement, to the American loan to Britain, to the negotiations on the International Trade Charter, and to the Geneva tariff reductions. This road, the indefatigable traveler hopes, will eventually lead to the final goal—a stable world with relatively free multilateral trade and the enormous benefits that would accrue from such trade to all who participate. Such a result, even if but partially achieved, would far outweigh the temporary, and minor, disadvantages more or less inevitably

* It might, however, be argued that a shortage of steel will prevent some industries from expanding investment in equipment and that this would, to some extent, counteract the inflationary effect of rising steel prices.

associated with its attainment. *Complete* failure to achieve it, moreover, would be a tragedy of the first magnitude not only on economic but, still more, on political grounds.

The attentive observer, however, is bound to note that, in spite of great efforts, the traveler has so far made but little progress. This seems to be largely because his companions, much weaker than he, must be constantly pushed as well as supported by him, because they march only halfheartedly towards the same goal and because they sometimes go off in a different direction whence they have to be pulled back. This, of course, slows down the pace at which the goal can be approached since the matter is, of necessity, a *group* enterprise.

It is the main purpose of this essay to show that the return of the Western world to a system of multilateral trade, free of the more obnoxious types of control such as foreign exchange control, quotas, import licenses, and the like, depends primarily on the general economic policy of the European countries (rather than on the amount of aid that they receive), and to indicate what kind of policy is required on their part if such multilateral trade is to be reëstablished. The essay will concentrate on the *economic* aspects of the foreign-aid problem. This does not mean that the writer believes that economic objectives are the really decisive factors. Political rather than economic fears, or hopes, are undoubtedly the driving force behind the whole program. More concretely, the major fear is that the economic distress of Western European countries will drive them to Bolshevism. The improvement in economic conditions which will result from American aid, whether or not such aid leads to the reëstablishment of multilateral trade, may well prevent this disastrous development. It is interesting to note that this piece of materialistic interpretation of history, according to which a nation can prevent other nations from adopting an undesirable ideology by granting economic aid, has, so far as the author is aware, remained unchallenged by any of the participants in the discussion, regardless of their political or intellectual background.

III. DOLLAR SHORTAGE

The American loan to Britain, however indispensable in furtherance of our long-term objectives, was a failure in the sense that it did not have the desired result of making the pound sterling freely convertible into dollars. The dollar shortage persisted. The proposed foreign-aid program, again, is intended to furnish European countries with current dollars in the hope that, after a few years, they will, through their exports, be able to earn the dollars required to finance their imports. Is there any guarantee, or reasonable expectation, that foreign aid will this time be more successful than has hitherto been the case?

It is somewhat disturbing, in the present discussion of the foreign-aid program, to find that it seems to be generally assumed 1) that the current dollar shortage is God-given and, over the next few years, can be alleviated only by what certain foreign countries tend, for this purpose, to regard as God's representative on earth, the United States Government, and 2) that the dollar shortage drives countries suffering from it into bilateral agreements among themselves. Neither of these propositions is at all self-evident. And, unless this is clearly realized, there is great danger that American aid to Western Europe will prove as inconclusive as the American loan to Britain.

"Dollar shortage" is not a new phenomenon of the post-war era. In the years 1934-39, Germany, for instance, suffered from a dollar shortage as well as from a shortage of every other freely convertible currency. The term may not have been widely current at that time but the thing described by the term was nevertheless present. In that period every reputable economist was convinced, and rightly so, that Germany's dollar shortage was the result of Germany's own policy. It was a matter of common consent among economists that the shortage resulted from two main policy decisions on the part of Germany: first, the decision to keep the mark, artificially, at its old gold parity, *i.e.* to stick to an exchange rate for the mark which greatly overvalued that currency, and second (inextricably linked with the first point), to devote an excessive quota of productive resources to the output of domestic commodities in the form of armaments as well as domestically consumed goods in general. Both of these factors are again responsible for the dollar shortage from which European countries now suffer. Military expenditures, of course, play a smaller rôle than in the case of Germany but the Harriman Report is quite right in pointing out that the domestic investment program of the sixteen European nations reporting to the United States is of such dimensions as, in all probability, to prevent these countries from reaching "self-sufficiency" by 1951.

Most economists would agree that a country with a free market economy internally, and a freely fluctuating exchange rate, could not suffer from a shortage of dollars, or of any other currency, no matter how poor the country in question might be. A shortage of foreign currencies can be defined only with reference to a given exchange rate. Foreign currencies are short if, *at that rate*, payments to foreign countries tend to exceed receipts from them. With freely fluctuating exchange rates a shortage of foreign exchange would, however, lead to such a rise in the value of foreign currencies as would bring payments and receipts into equilibrium regardless of the poverty of the country concerned.

Take, now, the other extreme: a centrally planned economy. Here the imports as well as the exports are decided by authoritarian action and a plan can be devised, theoretically at least, so that, at some more or less arbitrarily set exchange rate, the planned receipts from foreign countries will provide sufficient exchange to cover the planned payments to foreign countries. No general shortage of foreign currencies (or of any particular foreign currency), in any pregnant sense of the word "shortage," need then make itself felt no matter what the general economic condition of the country concerned might be. The country might, of course, want to borrow abroad in order to alleviate a scarcity of goods; but it makes no sense to say that such a country is suffering from a general shortage of foreign currencies or from a shortage of any particular foreign money. We do not speak about a "dollar shortage" in Russia but rather of a desire of Russia to borrow in the United States.*

If the Marshall plan works out, so that, for each and all of the borrowers, the future receipts from foreign countries roughly equate, at the established exchange rates, with the future payments to foreign countries, the currency of any of the countries can be made freely convertible into any other currency, including dollars, provided the countries in question have a sufficient reserve of foreign exchange to take care of minor and temporary discrepancies between payments and receipts *and* the currencies of other countries are freely convertible among themselves. If, however, the exports of any country go partly to countries which themselves prevent free convertibility of their currencies in any other, such as the dollar, the convertibility into dollars of the original currency will, of course, require a plan which, among other things, will determine the countries to which the given country's exports go and the countries from which its imports come.

A "dollar shortage," as it expresses itself in inconvertibility of a country's currency into dollars, can thus, in principle, be overcome in a planned economy, without any foreign aid, just as it is automatically overcome in a free economy with freely fluctuating exchange rates. In other words, any shortage of foreign currencies in general, or of a particular foreign currency, is the result of faulty planning, the main fault being that the domestic production and investment program absorbs an excessive proportion of the domestic productive resources and leaves an inadequate proportion for exports. The latter are then in-

* "Dollar shortage" seems to mean to the layman, and even to many economists, nothing more than that the country suffering from it cannot buy as many commodities in the United States as it would like to buy. In this sense every country may feel a dollar-shortage whether or not it has a free market economy and freely fluctuating exchange rates. The author, along with nearly everyone else, suffers from this type of dollar shortage. Such a use of the term deprives it of any significant meaning.

sufficient to buy the imports required for the execution of the domestic production and consumption plan.* If, moreover, the imports can come in the main from only one country, the fault in the plan will be predominantly reflected in a shortage of that country's currency. Such a shortage might be aggravated by another fault in planning which directs into wrong channels whatever exports the country may emit, *i.e.* into countries which do not permit convertibility of their currencies into the "short" currency. If Great Britain, and Western Europe in general, could in no way obtain aid from the United States, they would be *forced* to achieve an equilibrium in the balance of payments vis-à-vis the United States and to overcome the dollar shortage, by restricting imports or expanding (and possibly redirecting) exports, whether their economies were, or were not, planned; *i.e.* they would, with central control, be forced to achieve by conscious planning what a free market economy would achieve automatically, no matter how hardly, in either case, such a policy might bear on their suffering populations. They would, in short, be compelled to live within their means.

The proposition that the general shortage of dollars in foreign countries is, in large part, the result of faulty planning cannot be seriously questioned. Such a statement does not at all mean that foreign aid should not be given to Britain and other countries. Devastation has been great and need is intense. Commodities are extremely scarce. Our aid will relieve this scarcity both immediately, by facilitating imports of consumers' goods, and in the longer run by rendering possible the improvement of productive apparatus. Western Europe urgently requires all the aid that we seem at all likely to supply and, if our aid brings to pass the sort of world in which free enterprise can freely function, it will have been clearly in our own interest to give support, but if, with the extension of aid, adjustments in the present distorted composition of European industry are not immediately set in train, we shall find, at the end of a quinquennium, that we have made no progress whatever toward the attainment of the international economic system we seek to reëstablish. It is essential that we should all be aware of the true nature and causes of the dollar shortage since only then can we form a judg-

* This does not mean that a country should under no circumstances plan for a surplus of imports. Provided the country can obtain foreign loans, or gifts, to finance such a surplus, it may be in its interest (and in the interest of the world as a whole) to draft a production and consumption plan of which an import-surplus, covered by foreign loans or gifts, is an integral part. This is the situation which the Marshall plan envisages for the next four years. But, to secure foreign loans to finance larger imports does not involve a "shortage" of dollars in the sense that the recipient country's currency becomes inconvertible into dollars. When we ascribe a "dollar shortage" to "faulty" planning, we mean that, as a result of the defective general plan, a negative balance of payments develops which was no part of the intention and for the financing of which no foreign funds have been secured.

ment as to whether, and under what conditions, our aid can lead to the eventual reëstablishment of multilateral trade and free exchange markets. Once we are clear about the general causes of a dollar shortage we shall immediately realize that the possibility of an early return to multilateral trade by Great Britain, and the other countries involved, is not so much a function of the volume of aid given as of the policies adopted in the recipient countries. It would be sounder to regard our aid simply as a "grub-staking" of the countries of Europe, with consumers' and capital goods, instead of as a means of enabling them permanently to overcome the dollar shortage; and to look for the permanent solution of the latter problem in their own economic policy rather than in the amount of aid they now receive. If we treat the dollar shortage as what it actually is, a shortage of commodities which, because of faulty planning, shows itself in the form of a shortage of dollars, it becomes immediately apparent: 1) that it does not much matter whence the actual commodities may come, whether from the United States or other countries, and 2) that, no matter how much aid the European countries may receive from the United States, the dollar shortage will still be with us in 1952 if European production and investment plans remain faulty in the sense in which this term has been defined. To these two points we shall now give more detailed attention.

IV. BILATERAL AGREEMENTS

A country with a planned economy has the power not only to determine its total exports but also to determine the direction in which its exports will flow. A soft-currency country could, for instance, push its sales to a hard-currency country by the use of discriminatory exchange rates, or by subsidizing its exports to such a country, or by a general reduction in the exchange value of its money, and by so doing could relieve the shortage of the relevant currency. We find in fact, however, that many soft-currency countries prefer to export to other soft-currency countries with which they have concluded bilateral agreements. I say "prefer" deliberately; many economists would doubtless say that a soft-currency country is *forced* to export to other soft-currency countries in order to obtain the imports which it cannot buy from a hard-currency country because it is short of the hard currency. But, if it is true that the soft-currency country could push its sales to hard-currency countries by the methods described above, the word "prefer" is the appropriate word.

If a country may be presumed to act rationally, the explanation for bilateral agreements can be only 1) that the initiating country hopes to get better terms of trade than it could get in commerce with hard-currency countries, or 2) that the agreement is expected to induce the

partner country to lend to the initiating country in the form of an accumulation of unexpended balances in that country. In both cases the basic reason for concluding such agreements is the hope that the initiating country will acquire more commodities than it could obtain by trading with hard-currency countries. If the terms of trade in the bilateral exchange of goods were not more favorable than the terms of trade to which the initiating country would have to descend if it were to procure its imports from a hard-currency country, or if the initiating country did not expect to get a forced loan from the partner soft-currency countries, there would be no reason at all for such bilateral agreements. This only goes to show that it is commodities that the countries in question are after, and not hard currencies as such. They are quite willing to sacrifice the convertibility of their currencies on the chance of obtaining more commodities through bilateral deals.

This preference for bilateral deals is understandable when the hard-currency countries, through tariff policy, make it difficult to export to them; in other words, the terms of trade may perhaps be made quite unfavorable for the soft-currency countries by the tariff policy of the hard-currency countries. The tariff reductions negotiated in Geneva may therefore contribute substantially to the solution of the problem of the "dollar shortage."

It is obvious, however, that not all soft-currency countries can simultaneously gain in this fashion through bilateral agreements; and this is the reason why the benefits which may accrue to a stronger country in the agreement are likely to be merely temporary. The case of German trade with the South-Eastern European countries before the War has shown that the weaker partner in the agreement will eventually shift its exports to hard-currency countries in order to avoid exploitation. An analysis of the renewals of bilateral agreements either before or after the War would show that the countries which had accumulated balances in the partner country pressed for changes in the agreement which would allow them to convert their balances into hard currencies and/or remove the cause for such involuntary lending.*

V. ECONOMIC POLICY AND DOLLAR SHORTAGE

Faulty planning is all but inevitable under the conditions in which European governments now have to work. For this there are several reasons as follows:

* There is even a presumption against the notion that *any* country can gain through induced bilateralism since it is unlikely that the citizens of any country will gain as much from trade when, by governmental action, they are prevented from buying and selling where they please (that is to say in what is, for them, the best market) as they would gain if they were given freedom in the matter.