How the Marshall Plan stunted West German industrial recovery

by Susan Johnson, Managing Editor

There are two variants of conventional wisdom regarding West Germany's post-war economic history. The first is that through generous U.S. Marshall Plan aid, the Federal Republic was built up to the point of a potent competitor. The second version is that, after a period of punishing the German population for the Nazis' crimes, a policy faction in the United States and Great Britain recognized that to counter the Soviets, the territory on the front line of East and West would have to be helped to gain economic recovery, else the newly born NATO would have no defense base and no credibility. Therefore the Marshall Plan, or European Recovery Program (ERP), as it was officially called, generated West Germany's "economic miracle."

There is more truth to the second notion than the first, but they both evade the facts of the matter. The Anglo-American occupiers had dictatorial control over their territory, upon whose coal and steel the rest of Europe very much depended for its own short- and medium-term industrial needs. Therefore, if they had insisted on a crash recovery policy, they could have carried it out. Yet in fact industrial recovery was deliberately throttled in western Germany under the 1948-52 Marshall Plan.

Because of the post-1955 success in industrial innovation and manufacturing growth, after the Federal Republic gained greater sovereignty and the occupation restrictions on high-technology production were removed, the post hoc ergo propter hoc myth has been perpetuated that the Marshall Plan, not bootstrapping by the German population, produced "the German miracle."

The strategic dimension

The original Anglo-American plan for occupied Germany, the Morgenthau Plan, was to flood the Ruhr coal mines, dismantle all German heavy industry, and "pastoralize" a drastically shrunken population. What went largely unsaid is that the rest of Europe would have been utterly crippled as well.

The Churchillian strategists in England believed that, backed by America's military-strategic muscle, they could quickly wage what was referred to at the time, in Lord Bertrand Russell's approving words, as "preventive war" against the U.S.S.R., and thus had no need to rebuild Europe (or their own economies). As the reality of the Soviet nuclear armanent and stubborn re-industrialization emerged, along with the political impossibility of assembling a cold-war Western NATO bloc while decimating its industrial motor, western Germany, some way had to be found to cover the threadbare bottom of NATO for a longer-term military confrontation strategy.

Yet as the NATO rearmament push proceeded, there was no aggressive re-industrialization of West Germany. Output remained constricted, unemployment very high. Exports grew, subsidized by subminimal wages and throttled industrial investment. From the point of view of the Anglo-Americans, what was accomplished was to lock the Federal Republic under supranational control, as the Schumann Plan replaced the International Ruhr Authority in 1951, and the Bank deutscher Länder (BdL), the Bundesbank's predecessor, slavishly followed the prescription of the Bank for International Settlements in Basel that credit is inherently inflationary and that economic "booms" are a danger to be suppressed.

Occupation policy

In 1945, the industrial capacity of Germany's western zones was at least equal to pre-war levels (due to the policy of terror-bombing the population rather than knocking out industrial installations.) Plant and equipment, however, had been worked to the last nut and bolt by the Nazis; the agricultural produce of eastern Germany was cut off; transport was wrecked; food, fuel, infrastructural repairs and a revving up of basic coal and steel production were the elemental

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prerequisites for recovery of Germany, and thus of western continental Europe.

The Marshall Plan's official goals for Germany set the following priorities under these circumstances. First, ''balance of payments equilibrium by 1951-52'' and a large increase in exports. Second, ''regaining the pre-war level of industrial output.'' Third, a standard of living ''considerably lower than that in pre-war years''.

The payments deficit was indeed overcome. The method was achieving an export level modest compared with the potential, foregoing international borrowing, and above all holding down ''import demand'' on the part of the scarecrow population, i.e., keeping living standards ''considerably lower'' than under Hitler's austerity.

What was introduced is the policy the International Monetary Fund imposes on underdeveloped countries today. (The IMF itself was out of the picture at this point, being mandated to lend at commercial rates shattered Europe could not afford.) Industrial recovery, much less growth, was subordinated to the watchword of payments equilibrium, in West German foreign trade and in fiscal matters. Budgets were balanced, or ran surpluses, at the expense of urgent outlays. ''Self-financing'' was the chief mode of capital formation. A certain amount of infrastructural expenditure gradually took place to facilitate the export and defense push, but manufacturing output was kept below the late-1930s level until the Korean War. As Helmut Schmidt, commenting on the British occupation of Hamburg, once told Countess Marion Dönhoff of *Die Zeit,* ''They starved us to the point of insanity.''

The Marshall Plan, starting in late 1948, provided $1.4 billion in aid out of a total of some $14 billion in European funding over four years. (Total U.S., British and French aid to Germany in 1945-54 was about $4.4 billion, less than the present and future costs of defraying occupation costs, demontage, resumption of debt obligations, and so forth.) The ERP paid in dollars for imports of food, fuel, and other raw materials; the Germans were required to set aside a corresponding amount of marks, known as counterpart funds, over whose use the Economic Cooperation Agency (ECA), the U.S. administering body for the Marshall Plan, had full control.

After two years of the ERP, West German coal output was still below pre-war volume, and coal-mining productivity remained one-third below the pre-war level, because the Marshall Plan administrators refused to make real investment in the mines the Nazis had run, so to speak, into the ground. What was described as ''recovery'' was bringing industrial output from 51 percent of 1936 levels before Marshall aid (according to highly unreliable figures for both years) to 86 percent in April 1949, roughly the point at which the Anglo-Americans decided to place a higher priority on industrial functioning, for NATO purposes. At the beginning of the Korean War, industrial workers' real weekly earnings were still below the 1938 level; in 1952-53, daily caloric intake of the population as a whole was officially below the 3,000 calorie estimate for 1935-38.

To the extent a surplus was being produced, it was not reinvested from the point of view of the overall needs of the Federal Republic: basic industries received very little of it. In truth it was a nominal surplus, because it was gouged out of the productive potential of the present and future workforce, a nation's chief resource.

The equilibrium model

Consider briefly what would have occurred after World War II had the United States issued volumes of long-term, low-cost dollar credit sufficient for Western Europe to quickly rebuild and expand its industry, and, in partnership with American business, to create vast new markets in the post-colonial world for industrial goods, as Franklin Roosevelt had outlined to an apoplectic Winston Churchill in 1942-43. What happened instead is that the monetarists who controlled the commercial banks, the Federal Reserve and the Treasury enforced the Bank for International Settlements policy domestically as well as internationally. Americans focused on the expanding consumer sector; exports languished because dollars were lacking abroad to buy them. The Marshall Plan took the problem of the ''dollar shortage'' and institutionalized it as the premise of the post-war monetary system. Europe did not and would not have enough dollars to buy the essentials it immediately needed for recovery, much less capital goods for expansion. Therefore, the State Department said, Europeans must be aided with U.S. goods in the short run, to which certain ''conditionalities'' were attached: austerity at home, to ''fight inflation,'' and a drive to *reduce* their purchases of dollar-denominated imports in the medium term, procuring manufactures from each other and raw materials from the so-called ''dependent territories'' and British oil companies. A net *contraction* in U.S. exports to Europe was an explicit priority of the Marshall Plan. From $6.7 billion in 1947, before the plan began, the target was $2.7 billion for 1952-53 (compared with $3 billion in 1938, a year of intense Depression trade barriers and low demand). From the end of 1948 to the end of 1949, total U.S.-Canadian sales to ERP members, including Marshall-funded sales, dropped by 14 percent, and another 18 percent drop from that level was achieved by the third quarter of 1950, when the Korean War buildup began to reverse the situation.

This policy was sold to Americans under the banner of creating ''European self-sufficiency.''

The planners

The architects of the Marshall Plan did not find it odd for American policy to discourage American exports. They were the same investment bankers who had imposed the Versailles debt burden which catalyzed the Great Depression, and sponsored Hitler and Hjalmar Schacht in the 1930s against the German industrialists who wanted to re-launch ''American System'' policies.

Averell Harriman headed the committee that planned the ERP, became its European Administrator and represented the occupied German zones at the OEEC (the Organization for European Economic Cooperation, forerunner of today's OECD, which administered aid requests and economic policy as the European side of the Marshall Plan). Among Harriman's deputies were Robert Lovett of Brown Brothers Harriman, George Ball of Lehman Brothers (to which the Military Governor of West Germany, Gen. Lucius Clay, was also connected), and William Draper, Jr. of Dillon Read. Harriman's executive director was the British intelligence asset David Bruce of the State Department; his deputy general counsel was Henry Reuss, who as head of the U.S. congressional Joint Economic Committee later did so much to promote the "post-industrial" economy. Chief monetary adviser was the Belgian royal family's Robert Triffin, flanked by Harlan Cleveland (later of the Aspen Institute). The executive board of the OEEC, which formulated aid requests and transmitted supranational policy guidelines, comprised Sir Eric Roll, later of Warburgs in London, Baron Snoy of Belgium, and Giovanni Malagodi, another British/Warburg asset.

William Draper, Jr., who became Undersecretary of the Army in charge of the Marshall Plan and oversaw the occupation's economics division, was a frank advocate of world population reduction as the criterion of economic and military policy; he later founded the Draper Fund/Population Crisis Committee for this purpose. Draper's quondam underling George Ball has claimed in a recent interview that the Marshall Plan had as "a primary aim" curbing population growth, "because even after the war the problem was working like a time bomb. Even with the death and destruction in the war, modern health and sanitation facilities had decreased the infant mortality rate. We rebuilt slowly under the Marshall Plan because we did not want people to get the idea that prosperity was coming back." Or, as the State Department's Willard Thorp put it in *Foreign Affairs* in 1948, the ERP "does not even attempt to create what has been established in the past as a European standard of living."

For these policy makers permanent austerity was the essence of the Bretton Woods system, established in 1944. Its monetary correlate was as follows: The planned activation of internationally convertible gold-backed dollars as the world's chief reserve, generating liquidity for technological advances, had to be averted or postponed. After the Marshall Planners ensured that there was a post-war dollar shortage, Robert Triffin gradually introduced, as a condition of Marshall aid, the establishment of the European Payments Union, which in the name of expanding intra-European trade sought to minimize the need for dollar setlements. Europe, as a bloc, was to overcome its trade deficit with the United States by exporting cheap-labor-subsidized goods there, while for its part the United States actively strove to reduce its trade surplus in the name of international equilibrium. Europe was also to export "unsophisticated" goods to the Third World and build up the extractive industries of the "dependent territories" there yet American investors were told by the State Department not to invest abroad because of the danger of communist takeovers.

While Great Britain and Belgium were to resume their colonial ascendancy (Great Britain got the bulk of Marshall aid, and used it to retire debt while re-establishing its world financial position, but that is a story in itself), West Germany was assigned the role of NATO gendarme, under tight supranational control. France and Italy would be allowed the role of junior partners in this neo-colonial order. As the Marshall Plan was being worked out, Charles Kindleberger and Harold van B. Cleveland wrote in a State Department memo: "To avoid injuring sensitive feelings of nationalism, our appeal should be couched in terms of a European recovery which stresses the raising of European production and consumption through the economic and 'functional' unification of Europe. In our propaganda and in our diplomacy it will be necessary to stress (even exaggerate) the immediate economic benefits that will flow from the joint making of national economic policies and decisions."

The Marshall Plan's goal was to enforce austerity, not overcome it. The hard work and great suffering of the German population went into achieving 'payments equilibrium.' Even under conditions of NATO rearmament, occupied West Germany had no recovery program, inadequate heavy-industrial investment, and steep unemployment.

Implementation in Germany

From 1945 until mid-1948, the Anglo-American occupation let the German economy twist in the wind. The population was starving. Housing had been decimated, and by 1948, 8 million refugees had been carted into the Bizone (the joint U.S.-British occupation zone). Fertilizer and other imputs were not available to gear up food production. As for trade, nothing could be exported but coal (forced reparations at drastically reduced prices), wood, and steel scrap. The ceilings imposed on steel production could not even be reached. Barter was the dominant mode of economic intercourse. Hoarding naturally prevailed. Untold numbers died.

The Marshall Plan was inaugurated in Germany in 1948, not by an influx of aid, which began to trickle in late in the year, but by the sudden imposition in June of a currency reform which had been on the drawing board for at least two years. Apart from its political declaration that the Anglo-Americans intended to permanently divide Germany, the reform is conventionally described as the great trigger for West German recovery. It was indeed a turning point.

All currency and bank deposits of individuals, firms, and government bodies were converted at an effective rate of 100 to 6.5. The mark's foreign parities were de facto devalued at the same time. The rationale was that since goods were short, the money supply should be cut to fit that scarcity, rather than issuing targeted credit so that industrial output and worker productivity could be expanded. On the contrary, there was no overall recovery plan. One immediate result of the reform was that hoarded goods were released at profiteering prices, causing inflation; inflation then became the occasion for the occupation authorities to further tighten credit. Wholesale prices rose to 60 percent above 1936 levels, and 100 percent retail price increases were common, while wages were well below 1936 levels. After about six months, the economy was in sclerosis, while the United States itself, the Federal Reserve having tightened credit to combat business loan demand, began to slide into a recession that struck at the world economy as a whole.

The West German situation was universally recognized as disastrous by the end of 1949. The mark had been devalued again, by 21 percent, as part of the European devaluations forced by the Marshall Plan, raising dollar goods' prices for Europe an average of 44 percent. What supervened in 1950 was the Korean War and the momentum for European rearmament. After further credit tightening, justified in the name of combatting rising prices for imported raw materials, West German managed to double its exports and increase overall production to a level 11 percent above 1936. In 1951-52 the economy retreated again, but the occupation-controlled central bank, the BdL, continued its practice of braking any sign of an upsurge while refusing to counter downturns. Official unemployment stood at 10 percent at the end of 1952, and was still over 7 percent at the end of 1954.

Henry Wallich, now Paul Volcker's number-two man on the Federal Reserve Board, looked at this picture in his 1955 book *Mainsprings of the German Revival,* and concluded that the impressive thing about western Germany's post-war evolution was not a high level of exports per se. Exports were "modest," he concedes. "The low level of imports and the consequent balance-of-payments surplus are really the most miraculous phase of the German miracle." The key to the low level of imports, in turn, he concludes, was "the German diet," noting that Hitler's Reich, even at the height of autarky, imported more food than West Germany in 1952-53, though the Reich possessed the eastern "breadbasket." Caloric intake at that point in the 1950s was still below pre-World War II levels, and meat consumption was four-fifths of the wretched pre-war level. Thus "German income and production do not rank particularly high. . . . Today, nevertheless, Germany can look back upon four years of balance-of-payments surpluses."

The investment clamp

It is simply not the case that Marshall Plan funds provided an important proportion of post-war West German investment. Commodity aid, on the contrary, lubricated the imposition of an economic structure which discouraged crucial industrial investment. The counterpart funds at most averaged 3.5 percent of gross investment in the 1949-53 period, peaking during 1950 at 9 percent. At first they were frozen as a "counter-inflation" measure. They began to be released in the spring of 1949, when the NATO push got under way. Only 10 percent had been unfrozen as of the first quarter of 1950; then the Korean War situation impelled their use to try to open the coal and steel bottlenecks, about which very little had previously been done. Finally, as the ERP was transformed into the Mutual Security Agency in 1951-52, the counterpart funds were used for military-related purchases.

Most important regarding investment potential was the credit structure imposed by the currency reform and by the monetarist habits of the BdL. The occupation was supposedly committed to private-enterprise funneling of capital by thrifty and prudent savers into productive outlets. Yet, the 1948 currency reform defined savings deposits as cash, and thus wiped them out at the same 100 to 6.5 ratio.

No corporate stock market existed in occupied Germany, and private banks lent chiefly at short term. The main source of capital formation was plowed-back company profits; but steel and coal were not profitable. Much available capital flowed into luxury housing, nonessential consumer goods, and so forth; export-intensive producers were favored at the expense of restoring and modernizing the industrial base itself. Those who were able to invest their profits and receive huge tax write-offs were, as Wallich puts it, individually redeploying "the forced saving that business imposed on the consumer." The 12 to 14 percent rate of net investment as a proportion of GNP during 1948-49, for example, does not reflect a high absolute level of investment, but the wretched level of variable-capital outlays.

As a result of insufficient modernization and the effect of low living standards on skills and output, official productivity figures lagged, below pre-war levels until 1952, despite the Germans' hard work. In 1950, 25 percent of German families had no homes of their own (they were still living in bombed-out cellars, relatives' houses and so forth) and there were still half a million dwelling in camps as of 1954, the year when per capita income finally reached the level of guns-not-butter 1938 under Hitler. As the Bank for International Settlements had written after the first year of the Marshall Plan, "lack of capital will presumably continue to characterise the German economy for a long time to come."