Marshall Aid and the 'Shortage Economy' in Britain in the 1940s

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# Marshall Aid and the 'Shortage Economy' in Britain in the 1940s

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This article draws on two strands of recent discussion about the 1940s to analyse the significance of Marshall aid for Britain. On one hand is the re-evaluation of the strategic directions of the Attlee government's policies, which has focused attention away from the traditional emphasis on the nationalisation programme and the creation of the welfare state, towards the idea that this government was attempting to 'modernise' the British economy.[1] While the effectiveness of this attempt may be disputed, such an understanding of the government's concerns fits with the clear aims of the government to maximise exports and investment at the expense of both private and collective consumption.[2] While Zweiniger-Bargielowska has emphasised the political damage done to the government by that austerity, the particular concern here is with its economic implications.[3]

The other strand of relevant literature concerns the contribution of Marshall aid to the postwar economic recovery of Western Europe. This has been an object of much controversy in recent years, especially stemming from the attempt by Milward to argue that this contribution had previously been substantially overstated. The centrepiece of Milward's revisionist thesis was that when Marshall aid began to flow in 1947, Western Europe, far from being on the point of collapse, was suffering from the strains of a rapid recovery, and that the role of Marshall aid was to allow that recovery to continue, rather than being its source.[4] Milward focused on the aggregate impact of Marshall aid, putting its size in the perspective of the total GDP, foreign exchange earnings and investment of the Western European economies. Other authors have highlighted the impact of Marshall aid on particular sectoral

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[1] N. Tiratsoo and J. Tomlinson, *Industrial efficiency and state intervention: Labour, 1939–51* (London: Routledge, 1993).

[2] A. Cairncross, *Years of recovery: the British economy, 1945–51* (London: Methuen, 1986).

[3] I. Zweiniger-Bargielowska,'Rationing, austerity and the Conservative Party recovery after 1945', *Historical Journal*, Vol. 37 (1994), 173–97.

[4] A. Milward ,*The reconstruction of Western Europe 1945–51* (London: Routledge, 1987); Milward, 'Was the Marshall Plan necessary?' *Diplomatic History*, Vol. 13 (1989), 231–53.

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bottlenecks, where in quantitative terms its impact may have been much greater than for any of the national economies as a whole.[5] The collapse of communism in Eastern Europe reinvigorated the debate, because of talk of a 'new Marshall aid' plan for the former Soviet Union and its former eastern European satellites. Analytically, this modern concern tended to broaden the discussion of the impact of the original Marshall aid, especially in recognising that the dollars contributed by the United States could be seen not only as supplying resources to the recipient economies, but also as underpinning economic and financial, and in consequence, political, stability, with this in turn seen as an important ingredient of recovery.[6]

The debate about the impact of Marshall aid has been most extensive and vigorous in the case of West Germany, whose economic position was in many ways the key to the recovery of the whole continent, although, as many authors have pointed out, the West Germans received less Marshall aid than the British (although more aid relative to its GDP).[7] Examination of the impact of this aid on other continental European countries is generating an increasing flow of research, especially in relation to France and Italy.[8] In the British case, Milward's thesis seems to have generated less controversy than its application to that of West Germany. Much of the British discussion has concentrated upon the role of Marshall aid in foreign economic relations, both with the Sterling Area and with Western Europe.[9] The impact of Marshall aid on the British domestic economy has been dealt with surprisingly cursorily in the recent writing on the Attlee government's economic policies. Cairncross, for example, while making numerous references to the aid, treats it as a subordinate part of the process of dealing with Britain's dollar balance-of-payments problems, rather than being of great interest in its own right.[10] Pelling's treatment is dominated by the political aspect, and the more general histories of the

5 The sectoral impact is emphasised in K. Borchardt and C. Buchheim, 'The Marshall plan and key economic sectors: a microeconomic perspective', in C. Maier and G. Bischof, eds., *The Marshall plan and Germany* (Leamington Spa: Berg, 1991), 410–51.

6 B. Eichengreen and M. Uzan, 'The Marshall plan: effects and implications for Eastern Europe and the former Soviet Union', *Economic Policy*, Vol. 14 (1992), 14–54. The relevance of the Marshall plan to the reconstruction of Eastern Europe is assessed in R. Dornbusch, R. Layard and W. Nolling, eds., *Postwar economic reconstruction and the lessons for the East today* (Cambridge, MA: Harvard University Press, 1993).

7 C. Maier and G. Bischof, eds., *The Marshall plan and Germany* (Leamington Spa: Berg, 1991); A. Kramer, *The West German economy 1945–55* (New York: Oxford University Press, 1991), ch. 5.

8 I. Wall, *The US and the making of post-war France 1945–54* (Cambridge: Cambridge University Press, 1991), ch. 6; G. Bossuat, 'Le poids de l'aide Americaine sur la politique economique et financiere de la France en 1948', *Relations Internationales*, Vol. 37 (1984), 17–36; F. Lynch, 'Resolving the paradox of the Marshall plan: national and international planning in French reconstruction', *Economic History Review*, Vol. 37 (1984), 229–43; J. Miller, *The US and Italy 1940–50* (Chapel Hill, NC: University of North Carolina Press, 1986); C. Esposito, *America's feeble weapon: funding the Marshall plan in France and Italy, 1948–50* (Westport, CT: Greenwood, 1994).

9 M. Hogan, *The Marshall plan: America, Britain and the reconstruction of Western Europe, 1947–1952* (Cambridge: Cambridge University Press, 1987); C. Newton, 'The sterling crisis of 1947 and the British response to the Marshall plan', *Economic History Review*, Vol. 37 (1984), 391–408; E. Dell, *The Schuman plan and the abdication of British leadership in Europe* (Oxford: Oxford University Press, 1995).

10 Cairncross, *Years of recovery*, 83–6, 135–6, 140–3, 287–8.

period also tend not to offer much examination of the economic aspects.[11] However, it is difficult to understand the significance of Marshall aid in isolation from the highly peculiar character of the British economy in the years when the aid was received; hence there is a need to take into account the debate on modernisation and austerity in understanding the importance of Marshall aid for Britain.

## I

A very useful analytical starting point for understanding British economic history in the immediate postwar years is the idea of the 'shortage economy', as formulated by Josef Kornai.[12] This is a term he uses in analysing the then centrally planned economies of the former communist countries of eastern Europe, but which also seems to bring out key features of 1940s Britain.

The shortage economy is characterised first of all by excess demand. This demand is contained by some fiscal measures, but especially by physical controls. Comprehensive controls and rationing suppress inflation, but lead to the growth of grey and black markets, a well-known feature of Britain at this time.[13] Incentives to work are reduced because, despite full employment and high wages, wage-earners' purchasing power is ineffective because of the unavailability of many consumer goods.[14]

But in the shortage economy the problems do not all lie on the consumption side. The flexibility of the economy is radically reduced in these conditions of excess demand, because stocks fall too low for efficient working, generating what Hicks described as 'the empty economy'.[15] The situation of excess demand is created not only by a strong desire to consume, but by a large investment effort. This, certainly in the short run, itself adds to the squeeze on consumption. But because so much of the investment effort is concentrated on 'heavy' rather than consumer industries it does little to raise the supply of consumer goods, so that excess demand in that sector is sustained. While the former communist regimes were famous for their focus on, in Marxist terminology, 'Department One' industries, the same flavour can be found in the Attlee government's focus on 'productive' industries, and its disdain for 'wasteful' service activities.[16] Both represent a downgrading of the legitimacy of consumption. Last but not least, the shortage economy is characterised

[11] H. Pelling, *Britain and Marshall aid* (London: Macmillan, 1988); P. Hennessy, *Never again* (London: HarperCollins, 1992), 285–6, 291–9; K. Morgan, *Labour in Power, 1945–51* (Oxford: Clarendon, 1984), 269–72.

[12] J. Kornai, *The Socialist system* (Oxford: Oxford University Press, 1992), chs. 9–13.

[13] Hennessy, *Never again*; Public Record Office (hereafter PRO) CAB 134/509, Manpower committee 'Spivs and drones', Working party report, 12 Sep. 1947.

[14] W. Crofts, *Coercion or Persuasion? Propaganda in Britain after 1945* (London: Macmillan, 1989), 47, 57.

[15] J. Hicks, 'The empty economy', *Lloyds Bank Review*, Vol. 5 (1947), 1–13.

[16] PRO T229/28, Economic planning board, Central economic planning staff, 'Progress and prospects on Economic survey for 1947', 16 July 1947; *Economic survey for 1947* (London: HMSO), paras. 127–31.

by chronic balance-of-payments pressures, as domestic excess demand spills over into imports, while the strength of home demand reduces the incentives to export.[17]

If Kornai's approach helps us to understand the forces at work in the Attlee period, it is important to note that this situation was not invented by Labour in the summer of 1945. Much the same situation had existed through most of the war, with 'Keynesian' budgets supplemented by extensive rationing and controls. However, where the coming into power of Labour did matter was in its policy of easing the constraints on investment. While during the war aggregate investment had fallen to very low levels (with net investment becoming negative), after the 1945 general election investment boomed. This added a major twist to the problem of excess demand. Because Labour forswore the use of interest rates to contain investment, this demand had to be contained by physical controls. These ranged from building licensing to control of inputs, such as steel and timber, through to encouragement to machinery manufacturers to export their output, and direct controls on investment in the much expanded public sector. But because these controls were not very effective, especially in the short run,[18] the problems of the shortage economy of wartime were exacerbated rather than eased in the early postwar period.

This sketch of the shortage economy provides us with a useful way into understanding the debates which surround Marshall aid. It also allows us a useful retrospective angle from which to assess the significance of that aid for Britain's early postwar development.

## II

The primary purpose of Marshall aid was to finance higher levels of European imports from dollar countries. The scale of British receipts of the aid reflected the scale of her import dependence, which, of course, since the late nineteenth century had greatly exceeded that of other western European countries because of the policy of free trade and its radical impact on the volume of imports of foodstuffs and raw materials. Many of these imports came from the dollar area, and Table 1 gives some examples of the scale of British dependence on such sources in the late 1940s, which it should be noted had been scaled down during the Second World War.

About 40 per cent of Britain's Marshall aid dollars were spent on food, drink and tobacco, 40 per cent on raw materials, 7 per cent on machinery, and most of the rest on oil and oil products.[19] Any discussion of the allocation of Marshall aid must be put in the context of this long-established pattern of import dependence. Some have suggested that this policy reflected the wrong priorities of the Attlee government, and that too many dollars were spent on food and tobacco, and too few on

[17] Cairncross, *Years of recovery*, Conclusion.
[18] *Ibid.*, 448–55.
[19] HM Treasury, *Recovery record: the story of Marshall aid in Britain* (London: HMSO, 1951).

Table 1. *Dollar imports as a percentage of UK consumption of selected items in 1948*

| Item | Percentage consumption |
|---|---|
| Aluminium | 80 |
| Hides and skins | 80 |
| Wheat | 75 |
| Tobacco | 75 |
| Softwoods | 55 |
| Maize, barley and oats | 50 |
| Zinc | 50 |
| Cotton | 40 |
| Meat and bacon | 40 |
| Sugar | 40 |
| Oil and fats | 40 |
| Hardwoods | 35 |
| Cheese | 33 |

PRO T229/136, 'Marshall aid: alternative action in the event of breakdown. Report by committee', 17 July 1947.

investment goods. Could it be right to spend as much on tobacco as on machinery?[20]

A number of points need to be made about these figures. First, most Marshall aid did not go on consumer goods (including tobacco) of any type, over half being spent on raw materials and fuel, plus capital goods. Within this, the dominance of raw materials is unsurprising, given the scale of dependence on imports of these suggested by Table 1, and it is difficult to see how industrial recovery could have been so rapid without this boost to inputs of such a wide range of key materials. Second, as an index of British use of Marshall aid these raw figures are misleading, because they disguise the fact that the *incremental* value of Marshall aid to total dollar imports was greater for machinery than for food.[21] From this incremental point of view, it is also important to note that Marshall aid was used to increase more than tenfold imports of iron and steel from dollar countries.[22] This is particularly important because the shortage of domestically produced iron and steel was the key constraint on Britain's capacity to produce investment goods, so that the scale of this increment of imports here was a sign of the priority attached to investment by the British government. The whole issue of British investment is looked at in greater detail in a later section, but in the current context it is interesting to note the US response to Britain's proposed scale of machinery imports. The Americans were far from regarding this as a sign of flagrant disregard for economic reconstruction, but

20 C. Barnett, *Lost victory: British dreams, British realities* (London: Macmillan, 1996), 366–7.
21 Milward, *Reconstruction* ,104.
22 PRO CAB 134/217, 'Prospects under ERP', Annex B.

rather regarded the scale of the British requests as beyond the capacity of the US machinery industry to produce, and as part of a Europe-wide programme of imports whose scale exceeded those countries' capacity to put them to effective use. The London Mission of the Economic Co-operation Administration (ECA), created to distribute the aid, explicitly argued that, if Britain were to invest more, their resources could not result from importing extra US machinery, but from cuts in British exports of machinery, which in turn would only be possible in balance-of-payments terms if the total volume of Marshall aid were increased.[23]

All these points serve to undermine the idea that Britain blatantly 'misused' Marshall aid.[24] But they do not deal with the key point – whether in the deployment of that aid Britain was too tender to the consumption standards of the population, and spending too many dollars on food and tobacco. Two preliminary points may be made on this issue. First, as Milward has emphasised, *all* countries who received Marshall aid spent most of it on food.[25] Second, whilst Britain, as noted above, followed that pattern, it was still spending more dollars in total on raw materials than on food and tobacco.[26] Nevertheless, it is evident that the British did regard maintaining consumption standards as an important and legitimate use of Marshall aid. In judging the correctness of that decision it is useful to compare Britain's consumption standards with both its own past levels and with what was happening in other West European countries at the time. Table 2 shows that, unsurprisingly, food which could be produced readily in Britain, such as vegetables and dairy products, were relatively plentiful, but those imported in substantial quantities, such as meat and sugar, were heavily restricted in availability. Overall, calorie intake declined and there was a switch to high-carbohydrate items, such as potatoes and bread. The comparisons with other European countries (see Table 3) offer no evidence that the British consumer was treated with any greater indulgence than his or her continental counterparts.

Rather than suggesting any misdirection of imports, these figures are compatible with two other kinds of evidence of British consumption in the late 1940s. First are the figures on the macro-distribution of resources. Cairncross emphasised the extent to which growing output over the 1946–52 period was predominantly devoted to exports, which grew by 77 per cent, and investment, which grew by 56 per cent, whereas growth in consumption was held down to 5.9 per cent, when GNP growth was 16 per cent. This may have been highly responsible economic management, as Cairncross suggests, but it was politically increasingly unpopular, and research by Zweiniger-Bargielowska has plausibly linked this austerity in consumption standards

[23] PRO CAB134/215, Economic Policy Committee, 'ERP: Report by London Committee', 23 Dec. 1947; PRO CAB134/235, 'ECA's Mission Report', paras. 16–17.

[24] Barnett, *Lost victory*, ch. 19. For a sustained critique of this chapter see J. Tomlinson, 'Correlli Barnett's history: the case of Marshall aid', *Twentieth Century British History*, Vol. 8 (1997), 222–38.

[25] Milward, *Reconstruction*, 105.

[26] In 1949/50 Britain spent \$637 million on raw materials, \$210 million on petrol, \$622 million on food and tobacco, \$122 million on equipment and \$35 million on other items. OEEC, *Report to the ECA on the 1949/50 programme*, Vol. II (Paris: OEEC, 1949), 259.

Table 2. *Changes in average daily British food consumption, 1938–48/9*

| 1938 | (grammes per head unless otherwise stated) | 1948/9 |
|---|---|---|
| 42.7 | Animal protein | 39.5 |
| 37.2 | Vegetable protein | 44.8 |
| 38.3 | Dairy products | 45.8 |
| 109.6 | Meat | 74.7 |
| 32.8 | Fish, grain and poultry | 38.2 |
| 24.5 | Eggs | 22.1 |
| 45.0 | Oil and fats | 37.3 |
| 109.9 | Sugar and syrups | 80.8 |
| 176.0 | Potatoes | 297.4 |
| 141.5 | Tomatoes and other fruit | 145.0 |
| 209.8 | Grain products | 260.0 |
| 14.7 | Tea, coffee and cocoa | 14.1 |
| 3000 | Total calories | 2890 |

Table given in PRO CAB134/217, Economic Policy Committee 'Economic Recovery Programme: food supplies', 11 May 1948.

Table 3. *Per capita consumption expenditure, 1938, 1947, 1950*

| | (at constant prices, 1947=100 except for West Germany) | 1938 | 1947 | 1950 |
|---|---|---|---|---|
| *UK* | Food, drink and tobacco | 101 | 100 | 99 |
| | Clothing | 124 | 100 | 119 |
| | Durable household articles | 135 | 100 | 126 |
| *France* | Food and drink | 122 | 100 | 121 |
| | Clothing | 115 | 100 | 101 |
| | Durable consumer goods | 104 | 100 | 116 |
| | | 1936 | 1949 | 1950 |
| *West Germany* | Food, drink and tobacco | 123 | 100 | 103 |
| | Clothing | 138 | 100 | 138 |
| | Household articles | 115 | 100 | 139 |

United Nations Economic Commission for Europe, *Economic survey of Europe since the war* (Geneva: UN, 1953), 63.

to growing disillusion with the Labour government, especially among women, and its loss of office in 1951.[27]

Finally, on this issue of consumption it is instructive to look at the case of tobacco. The previous paragraphs have suggested that Britain's food imports did not put it out of line with the levels of consumption in West Germany and France, nor were they excessive in comparison with prewar levels. However, can the levels of

27 Cairncross, *Years of recovery*, 24, 499–500; Zweiniger-Bargielowska, 'Rationing'.

dollar expenditure on tobacco be seen as other than extravagant? Britain proposed to spend $18 million of Marshall aid on tobacco (5 per cent of the total) in its original programme – as much as on machinery. In the late 1940s Britain was spending just over $100 million a year in total on tobacco from the dollar area, several times the amount spent by any other European country.[28] In judging this use of dollars it is first of all important not to impose a 1990s perception on tobacco use. Whilst the harmful effects of smoking on health had been discovered in Germany in the 1930s, they did not become widely known until the 1950s. For a much larger number of people than today, tobacco consumption was a taken-for-granted and pleasurable consumption habit, which added significantly to the quality of life. Consumption of American tobacco had spread substantially during the war, and politically, any government which wanted to maintain popular morale would have had great difficulty in cutting tobacco consumption significantly in Britain in the 1940s. But even in purely economic terms it is possible to defend the government's policies. First, the American government was extremely keen for the British to spend dollars on the products of American tobacco farms, and offered substantial price subsidies as an encouragement.[29] Second, tobacco was very heavily taxed in Britain, so that any significant reduction in imports would have had a serious fiscal impact, at a time when the government was desperate to raise revenue, but anxious about the adverse effects on incentive of any increase in direct taxation.[30]

Overall, given the myriad of constraints, the expenditure of Marshall aid dollars on consumption items by Britain does not seem to have been extravagant. This point is reinforced when we note the 'psychological' or incentive effects of supplying the population with a reasonable quantity of consumer goods. This was a period when the British government was putting a great deal of emphasis on the need for higher labour productivity and the need to motivate the working population to more effort.[31] A shortage of consumer goods was a highly demotivating factor, and this was increasingly recognised by the government.[32] Hence decisions on consumption levels had to take into account 'feed-back' effects on production.

## III

Marshall aid was about supplying dollars to countries which could not obtain enough of them in any other way. Marshall aid dollars were credited to the British

28 United Nations Economic Commission for Europe (henceforth UNECE), *Economic survey of Europe since the war* (Geneva: UN, 1953), 292. Note, however, that by far the most rapid rise in dollar tobacco imports was to Germany, attributed (p.89) by the UN to the influence of US servicemen in Occupied Germany.

29 Pelling, *Britain*, 47; Milward, *Reconstruction*, 121.

30 Tomlinson, *Democratic socialism and Economic Policy: the Attlee Years* (Cambridge University Press, 1997), ch. 12.

31 Tiratsoo and Tomlinson, *Industrial efficiency*; Tomlinson 'Mr Attlee's supply-side socialism', *Economic History Review*, Vol. 46 (1993), 5–6, 16–17.

32 Pelling, *Britain*, 47; Zweiniger-Bargielowska, 'Rationing', 178–81.

Table 4. *Uses of counterpart funds in major European countries*

| | Debt retirement or unutilised | Production and other purposes |
|---|---|---|
| | (per cent) | |
| United Kingdom | 100 | 0 |
| France | 8 | 92 |
| W. Germany | 9 | 91 |
| Italy | 14 | 86 |
| Norway | 100 | 0 |
| Denmark | 83 | 17 |
| Netherlands | 62 | 38 |
| Austria | 46 | 54 |
| Greece | 45 | 55 |
| Average for all countries (including those not listed above) | 46 | 54 |

W. A. Brown and R. Opie, *American Foreign Assistance* (Washington, DC: Brookings, 1953), 244.

government's account with the Bank of England, and the companies or government ministries which obtained goods paid for with those dollars in turn paid for them in sterling, creating what were called 'counterpart' funds. Counterpart funds were therefore the domestic currency equivalent of the dollars made available to European countries under Marshall aid. In accordance with US desires, these funds were overwhelmingly used for two purposes, either investment or debt retirement. The mix of these uses varied enormously, with some countries using the whole allocation for debt retirement, whilst others used the great bulk for investment. These patterns are shown in Table 4. Clearly Britain's use of counterpart was atypical, only Norway similarly devoting all of the money to debt retirement. Why did Britain adopt this use of counterpart? The simple answer is that in the peculiar circumstances of the 1940s shortage economy, this was the best use of the money. But this proposition requires substantial elaboration.

The aim of debt retirement was to reduce inflationary pressure in the economy by reducing its credit base. Much informed opinion at the end of the war reckoned inflation as a, if not *the*, major threat to rapid economic improvement. Economists put great weight on this aspect of the recovery programme from the beginning, recognising the huge inflationary potential from the build up of 'blocked' purchasing power and excess liquidity in the war years.[33] This point of view was readily accepted by those who legislated for and administered the counterpart aspect of Marshall aid. Esposito provides a detailed account of how the United States tried to balance the anti-inflationary and production goals of counterpart in France and Italy. In the former case the aim was to constrain what was seen as the excessively expansionary and inflationary policies of the French government, in the latter it was to try and prevent a too deflationary policy being pursued.[34] What emerges clearly

[33] For economists' views see, for example, J. Gurley, 'Excess liquidity and European monetary reforms, 1944–1952', *American Economic Review*, Vol. 43 (1953), 76–100; G. Haberler, 'The European recovery programme', *American Economic Review*, Vol. 38 (1948), 495–518.

[34] Esposito, *America's feeble weapon.*

from this analysis is the equal weight given by the United States to containing inflation and expanding production. Recent analysis in the context of talk about 'Marshall aid' for post-communist societies has reiterated the place of financial stabilisation goals as central, and rightly central, to the Marshall programme, rather than the traditional emphasis on the funding of imports and investment in recipient countries.[35]

In formulating their claim for the use of counterpart, the British made explicit their awareness of the twin aims of American policy regarding the use of this money. They argued that the existing level of investment was all that could be allowed given the balance-of-payments constraint and the inflationary dangers of too high a level of investment.[36] With this strategy in mind, the government and the Bank of England established procedures for dealing with counterpart, aimed at forestalling any inflationary impact. These procedures were elaborate, including the creation of a special account at the bank, but their overall impact was described in the following terms by a Bank of England official:

The impact of Marshall aid on the national finances is as follows:

(a) floating debt *with the market* is reduced when dollars (or goods bought by Departments for dollars) are sold to the trade;
(b) *the total* floating debt is reduced when sterling is transferred to the 'Special Account' (but an equivalent amount of 'Other Internal Debt' i.e. Notes, is created);
(c) the total of the *National* debt is reduced when the 'Special Account' is debited for the repayment of the Notes.[37]

The *Financial Times* emphasised the 'disinflationary' impact of counterpart arising from the use of money from the sale of Marshall aid goods to reduce the floating debt: 'There is, therefore, no reason to suppose that the somewhat elaborate arrangements being made for setting aside the local currency proceeds of Marshall aid will have any important practical impact upon the credit structure . . . There is, in practice, no more disinflationary way of utilising the local currency derived from sales of ERP goods than employing them for cutting down the amount of government borrowing from the private sector of the economy.'[38]

The ECA, in response to the British, endorsed these arguments in the following terms: 'As a result of the policy followed in the UK from the end of the war to August 1947 of trying to do "too much in too short a time" the British economy had become so overcommitted in terms of its available resources, that the whole economy was in danger of collapse and runaway inflation.'[39] It followed that the

[35] Eichengreen and Uzan, 'Marshall plan'; I. Wexler *The Marshall plan revisited: the European Recovery Programme in economic perspective* (Westport, CT: Greenwood, 1983), 97, summarises the US view: 'If a strong production effort was to constitute the primary economic element of the recovery programme, the creation and maintenance of internal financial stability was to run a close second.'

[36] PRO CAB 134/215, 'ERP: Report of London committee', especially paras. 54–5.

[37] Bank of England Archive, C40/485 'ECA: ERP Special Account' K. Peppiatt to Governor, 14 July 1948.

[38] *Financial Times*, 12 July 1948, 'Proceeds of ERP'.

[39] PRO CAB 134/235 'ECA's mission report', para. 25.

ECA initially had no difficulty in endorsing the British proposal for using counterpart to retire debt and to help ease inflationary pressure, rather than using it for attempts to expand productive capacity, which would have worsened that pressure.

However, some American opinion was unhappy with this use of counterpart, as it did not seem to fit with the proclaimed aim of Marshall aid to rebuild the productive capacity of the West European economies. As the *Economist* put it, complaints were being made by Congress that 'while the virile continentals were using American funds to expand production, the slothful British were letting half their money waste away'.[40] As in other areas of Marshall aid administration, the ECA found itself caught between doing what it saw as economically appropriate and doing what Congress seemed to want. As a senior official in the London ECA noted, 'there was a feeling in some sections of the ECA that use of these funds for direct investment projects would be a useful method of bringing home to the general public both in Britain and in the United States the extent to which ECA grants were making it possible for the British economy to maintain the high level of investment essential to recovery'.[41] But given that the ECA accepted the British view that total investment could not be increased, the logic of this attempt to appease congressional opinion would be a purely book-keeping change, where increased investment from counterpart would be offset by increased debt retirement from the ordinary British budget. The British understood that, as the *Financial Times* put the point: 'It is not the intention, however, to urge a reduction in the amount of debt retired or any slackening of the pressure against inflation.'[42] Unfortunately for the London ECA, however, the British government had political problems of its own with such proposals. They argued that any increase in the budget surplus to finance increased debt retirement was politically impractical, 'since it would appear to the British public that the larger budget surplus presented an opportunity either for reducing taxes or for increasing other forms of government expenditure'.[43] The result was that whilst for a time the ECA withheld permission for counterpart to be used for debt retirement, in the end it relented. In large part this seems to have been because with the cessation of Marshall aid to Britain the political heat of the issue diminished,and neither side wanted the disposition of counterpart to be left as a loose end.[44] It is interesting to note that, as in Italy and France, the amount of effective leverage over a European country's policies given by the allocation of counterpart turned out to be very limited.[45]

As the previous paragraphs have shown, the ECA accepted the economic logic of the British case for the use of counterpart to retire debt, even though this faced

[40] *Economist*, 2 Feb 1952, 300.

[41] National Records Administration, Washington DC Record class RG469/392. ECA London mission. UK Subject files, box 10. Finance Division to R. Batt 'Use of counterpart funds' 5 July 1951, para 1.

[42] *Financial Times*, 16 Dec. 1949.

[43] NRA RG469/392, 'Use of counterpart funds', para. 4.

[44] PRO FO 371/87006, 'Use of UK counterpart funds'; T232/235, 'The uses of counterpart funds for UK economic recovery'.

[45] Esposito, *America's feeble weapon*, conclusion.

them with political problems. This acceptance was based on the realisation that by the time Marshall aid became available in 1948, Britain was running fiscal surpluses which were to rise to over 6 per cent of GDP in the late 1940s.[46] It made sense to allow the use of counterpart to reinforce this policy, given that even with this scale of fiscal surpluses Britain was suffering from excess demand.

It is interesting to note the similarities between the British political and economic situation in this period and that of Norway, the other country which devoted all of its counterpart to debt retirement. Both countries had strong Labour governments which used their political strength to pursue policies of austerity in consumption, allowing for rapid growth in investment. Starting from a much higher level than Britain, Norway soon had the highest ratio of investment to national income of any country in the West.[47] In both countries public-sector saving was based on high taxes and budget current-account surpluses.[48] In Norway, as in Britain, the government believed that investment was constrained by the lack of availability of real resources rather than of finance.[49] Because of their investment booms, both countries suffered from strong inflationary pressures. In Norway these pressures were effectively suppressed until 1949, but for the next three years prices rose at almost 10 per cent per annum.[50] This open inflation reflected a substantial easing of direct controls, and the attempt to put more reliance on monetary and fiscal policy to regulate demand. It was in this context that the use of counterpart to retire debt appeared attractive. As in the British case, this use came under criticism from Washington in late 1949, but was stoutly defended by the Norwegian government on anti-inflationary grounds.[51] Like the Attlee government, leaders of the Norwegian government regarded the American attitude as extremely unhelpful because it undermined resistance to pressures for higher government spending based on the existence of fiscal surpluses, and hence to policies to control inflation. Fortunately for those leaders, the coming of the Korean war so altered the situation that Norway was able to continue with its devoting 100 per cent of counterpart to debt retirement until Marshall aid ceased.[52] This comparison suggests that in explaining the differing uses of counterpart we should focus attention on the overall strategy of economic policy in the recipient countries rather than looking too much to 'idiosyncratic' responses to Marshall aid.

46 The fiscal surplus is calculated by Cairncross, *Years of recovery*, 421.

47 A. Bourneuf, *Norway: the planned revival* (Cambridge, MA: Harvard University Press, 1958), 1.

48 *Ibid.*, 53–4.

49 *Ibid.*, 54.

50 F. Hodne, *The Norwegian economy 1920–1980* (London: Croom Helm, 1983), 163–5.

51 H. Pharo, 'The Marshall plan and the modernisation of the Norwegian economy', in *Le Plan Marshall et le relevement economique de L'Europe: colloque tenu a Bercy les 21, 22, 23 Mars 1991* (Paris: Ministere des Finances, 1993), 593–605; *idem*, 'Norway, the United States and the Marshall plan, 1947–52', in R. Griffiths, ed., *Explorations in OEEC history* (Paris: OECD, 1997), 73–85.

52 Pharo, 'The Marshall plan', 601–4.

Table 5. *Gross investment levels in Western Europe in the late 1940s*

| | 1938 | 1948 | 1949 | 1950 |
|---|---|---|---|---|
| | (Gross domestic fixed capital formation as a percentage of GDP) | | | |
| UK | 14 | 13 | 13 | 13 |
| France | 15 | 19 | 18 | 18 |
| West Germany | 16* | 17 | 19 | 20 |

* 1936.
*Economic survey of Europe since the war* (Geneva: UN, 1953), 56.

## IV

The view that Britain invested too little is a longstanding criticism of British policy in this period.[53] As measured by the share of GDP devoted to fixed investment at the end of the 1940s, the basis of this adverse judgement is clear from the statistics given in Table 5. While the precise percentages should be treated with caution, it seems clear that, in comparison with West Germany and France, Britain was investing less. Marshall aid was seemingly not used to raise investment to West German levels. The key questions to be asked of the British investment effort are: what constrained its growth, and could Marshall aid have been more effectively deployed to ease those constraints?

However, before looking at the constraints on investment in Britain it is worth noting some qualifications to simple notions that British investment at this time was 'too low', and that this was plainly the main cause of later failings in the growth performance of the economy. On the scale of the investment effort, whilst Britain's investment as a proportion of GDP was lower than the West German, given the disparities in GDP at that time, the absolute level was similar in the two countries.[54] Second, the table disguises the fact that, given the very low level to which investment fell in Britain during the war, the increase in the immediate postwar years 1945–7 was very fast. Feinstein calculates a trebling of the investment proportion between 1945 and 1947. Especially in these early years, Britain was investing a high proportion of the *increment* in GDP, and because of the fall of the share of investment allocated to housing after 1948, the volume of industrial investment was still strongly upwards thereafter.[55]

Whether more investment was the key to improved British economic performance remains a controversial issue. The role of investment in growth has been, and of course remains, an area of theoretical as well as empirical dispute. However, the Attlee government and its advisers broadly accepted the idea that a strong positive, causal link existed, though they were also keen to encourage improvement in such

[53] Shonfield, A., *British economic policy since the war* (Harmondsworth: Penguin, 1959); J. Viner, 'An American view of the British economic crisis', *Lloyds Bank Review*, Vol. 6 (1947), 28–38.
[54] UNECE, *Economic survey*, 61.
[55] C. Feinstein, *National income, expenditure and output of the United Kingdom, 1855–65* (Cambridge: Cambridge University Press, 1972), Table 2; UNECE, *Economic survey*, 60.

areas as management and the proportion of resources spent on research and development.[56] Retrospective empirical assessments have been more sceptical about higher investment as the sovereign remedy for Britain's economic weaknesses, pointing out the low increments of output Britain managed to generate from higher investment.[57]

Whatever retrospective judgements may suggest, Attlee's government would have liked to increase investment faster, but was tightly constrained in doing so. In their claim for Marshall aid the British spelt out those constraints. 'The effective limits on investment are three: the need for countervailing savings; the limits imposed by raw material supplies; and the limits of the productive capacities of the building and engineering industries.'[58] The first of these problems was dealt with by generating from 1947 a large public-sector surplus, given that private-sector savings were at a very low level in the wake of the war.[59] The other constraints were essentially balance-of-payments, and above all, dollar availability problems. In the case of raw materials, as noted above, a large proportion came from the United States. In the case of the capacity of the building and engineering industries, the problem of importing more US equipment has already been noted. But in addition there was a very serious problem for the British of trading off the use of engineering goods for domestic investment against using them to earn export revenue. This dilemma was recognised by the ECA, when it noted that Britain's investment level could only be expanded if the capital goods diverted as a result from export to domestic use were then replaced by other sources of foreign exchange.[60]

The crucial point about the constraints on investment in Britain in this period is that the problem was one of foreign exchange, overwhelmingly dollars, and the physical resources, such as steel, that at the margin only dollars could buy. Conversely, investment was *not* constrained by lack of investment demand nor, crucially, by the lack of availability of finance to back that demand. In the private sector investment demand was booming at the same time, since companies held large accumulations of cash from the war period and continued to acquire more by high levels of profitability.[61] Similarly, in the expanding nationalised sector, the government pushed ahead with as large scale re-equipment as was possible, given

[56] A major recent contribution to the theoretical debate on the role of investment is M. Scott, *A new view of economic growth* (Oxford: Oxford University Press, 1989), and the whole area has been revolutionised by 'new growth theory'; see, for example, N. Crafts, '"Post neoclassical endogenous growth theory": What are its policy implications?' *Oxford Review of Economic Policy*, Vol. 12 (1996), 30–47; on the Attlee government's role as a moderniser of industry, see J. Tomlinson, 'Mr Attlee' 1–22; Tomlinson, *Democratic socialism*, ch. 5 ; PRO CAB 134/235 'ECA's Mission Report', para. 75. This report strongly commended the government's actions on the productivity front, especially with respect to persuading workers and unions to take a positive stance on measures to increase productivity.

[57] Summarised in C. Schenk, *Britain and the sterling area: from devaluation to convertibility in the 1950s* (London: Routledge, 1994), 98–101.

[58] PRO CAB 134/234, 'Draft Long-term Programme', para. 150.

[59] Cairncross, *Years of recovery* , 421.

[60] PRO CAB 134/235, 'ECA's Mission Report', paras. 12–17.

[61] Tomlinson, 'Mr. Attlee', 11–12; T. Barna,'Those "frightfully high" profits', *Bulletin Oxford University Institute of Statistics*, Vol. 11 (1949), 213–26.

labour and steel availability, but without any evident concern with the financial consequences.[62] The absence of a financial constraint completely undermines the idea that counterpart could have been used to raise the British investment level. The dollars of Marshall aid did ease the key constraint on investment, but counterpart, by definition being in sterling, could do nothing to help the position. The dollars could not be spent twice. As the *Economist* tartly noted: 'There is, of course, no such thing as a spendable "sterling counterpart" to dollar aid of this sort; the fact that the country is living so far beyond its means that it has to go on the dole, does not mean that the Government can legitimately sell that dollar dole for sterling, and then use the sterling for living beyond its means still further.'[63]

Counterpart aid was adapted to conditions which did not exist in Britain, above all where there was a domestic financial constraint on investment. In the case of France this was especially a problem for the public budget, which was constitutionally constrained from going into deficit, but where there was very strong demand for publicly financed investment.[64] In these circumstances counterpart could ease the financing constraint by adding to public revenues and eliminating the budget deficit.

Similar financing issues arise in relation to the West German use of counterpart. Here the contrast with the British case can be seen by looking at investment in the two countries' electricity industries. In the case of West Germany the electricity industry shared the problems of the rest of the corporate sector of financial disorganisation and illiquidity. The demand for electricity was rising, but 'the industry faced a difficult situation because long-term investment funds could not be obtained on the capital market. Internal financing was very difficult, as the price of electricity was controlled and could not be raised very much for social reasons. Profit margins were therefore slim, especially as the price of coal inputs rose'.[65] This financial problem in such a crucial industry led inevitably to the government stepping in, with the use of counterpart funds.

About 25 per cent of all West German counterpart was devoted to the electricity generating industry. Whilst the precise contribution of counterpart aid cannot easily be calculated, between 1948 and 1952 such funds financed, at least partially, projects amounting to 70 per cent of total capacity expansion. Detailed analysis of the conditions in Germany at this time suggests that the normal operations of the capital market were quite incapable of financing such an expansion.[66]

In Britain the newly nationalised electricity industry faced a similar situation of excess demand and pressures to expand capacity. The constraint on such expansion

[62] See the final section below.

[63] *Economist*, 2 Feb. 1952, 300.

[64] *Ibid.*, and Esposito, *America's feeble weapon*, ch. 2.

[65] K. Roskamp, *Capital formation in West Germany* (Detroit: Wayne State University Press, 1965), 39–40, 44, 119.

[66] Borchardt and Buchheim, 'Key economic sectors', 431–49. W. Abelhauser, 'American aid and West German economic recovery: a macroeconomic perspective', in C. Maier and G. Bischof, eds., *The Marshall plan and Germany* (Leamington Spa: Berg, 1991), 367–409, disputes the importance of counterpart funds in West German reconstruction, but still focuses on finance as the constraint on investment.

in Britain was not financial but that of physical resources, especially steel. Generating plant could simply not be built at a rapid enough rate in the United Kingdom, and the dollar shortage constrained imports from the United States. Financial budgets for the electricity industry were drawn up after the future investment level had been determined by the allocation of steel and other materials.[67] The question of using counterpart funds in the electricity industry never arose; in the circumstances of Britain the funds were an irrelevance to that industry's problems. The question of budget deficits did not arise because from 1947 the government was running large budget surpluses. Equally, the corporate sector was flush with funds and the capital market was fully functioning, having suffered none of the wartime disruption experienced on the Continent. The only important issue was how many Marshall aid dollars could be devoted to investment purposes, and here the impact cannot be directly measured by the purchases of capital equipment paid for with those dollars. The government had to go on importing raw materials and consumption goods on a large scale, given Britain's import dependence in these areas. Equally, it had little choice but to devote considerable amounts of resources which could have gone into investment to exports. Finally, despite its belief in the investment-growth link, it had in fact to *constrain* investment through the whole of its period of office because of the damage excessive investment could do. This point is so at variance with common views about the needs of the economy at this time that it needs explaining in some detail. As with previous points, this final one can only be understood by placing it in the wider context of the peculiarities of the shortage economy in the 1940s.

## V

As noted above, the extra twist given by the Attlee government to the shortage economy was the unleashing of investment demand. The attempt to control this demand by administrative measures was, especially initially, extremely unsuccessful. Partly this was for crass reasons, such as licensing more building work than the resources were available to complete. But also the administrative apparatus to police such controls was inadequate. In the crucial case of building, for example, more licences to build were issued than could be matched by the availability of bricks. But also, in an industry characterised by a vast number of small, often one-person, firms the pattern of building activity was very difficult to police. Workers were constantly being pulled into the repair and maintenance of houses, where demand was very strong, away from the activities given priority by the government.[68]

67 PRO T237/39, T237/40 Marshall aid 'Purchases of boiler plant by British Electricity Authority' 1949, 1950; L. Hannah, *Engineers, managers and politicians: the first fifteen years of nationalised electricity supply in Britain* (London: Macmillan, 1982), 26, 45–6. The industry, it should be noted, was reluctant to use differential pricing to try and restrain demand growth: M. Chick, 'Marginal cost pricing and the peak hour demand for electricity', in Chick, ed., *Governments, industries and markets* (Aldershot: Elgar, 1990), 110–26.

68 N. Rosenberg, *Economic planning in the British building industry 1945–49* (Philadelphia: University of Pennsylvania Press, 1960), 137–50.

The result of all this very strong desire to invest along with weak controls was a 150 per cent increase in fixed investment in 1946, and a consequent scramble for investment resources which left the country scattered with half-finished projects. Only slowly did the government get on top of the problem, a major impetus coming from the balance-of-payments crisis of 1947. In the second budget of that year demand was reined back, and this is most evident in the movement to budgetary surpluses. Traditionally this movement in 1947 to use the budget to regulate demand has been interpreted as a switch from Labour's commitment to economic planning to a 'Keynesian' policy of using fiscal policy.[69] However, as recent research has shown, many in the Attlee government had come to recognise that, with constant excess demand, 'planning' could not be effective, so that a tight budgetary policy was seen as much as a pre-condition as a substitute for physical planning.[70]

Alongside this fiscal tightening, investment cuts were also planned, but in fact the volume of gross fixed capital formation continued to rise, albeit more slowly, because of the inadequacy of the controls, as well as ignorance about what was actually happening to investment.[71] The idea of cutting investment as part of the overall reduction in aggregate demand was strongly supported by economists. Lionel Robbins, for example, said that the biggest problem for the economy was the existence of 'vast schemes of development and capital expansion which have been undertaken by government and by business with the active encouragement of the government. We have been suffering from a sort of megalomania'.[72] Hicks similarly argued against the prevalent assumption that Britain should pursue major industrial reconstruction: 'As things are, major reconstruction is not a thing that we can possibly afford. If we try to undertake it, we shall merely experience recurrent breakdowns of the kind we experienced in the coal crisis of the spring.'[73] James Meade, the government's chief economic adviser in 1945/6, had recognised excessive investment as a major part of the excess demand problem in the advice he gave to the government. For example, in January 1946 he wrote that 'investment which was not going to be of immediate help to the export industries or which was not in the development regions should on general employment

69 On economic planning generally see S. Brooke, 'Problems of "socialist planning": Evan Durbin and the Labour government of 1945', *Historical Journal*, Vol. 34 (1991), 678–702; Tomlinson, *Democratic socialism*, ch. 5.

70 N. Rollings, 'The "Keynesian revolution" and economic policy-making: a comment', *Economic History Review*, Vol. 38 (1985), 95–100; Rollings, 'British budgetary policy 1945–1954: a "Keynesian revolution"?' *Economic History Review*, Vol. 41 (1988), 283–90; A. Booth, *British economic policy, 1931–49: was there a Keynesian revolution?* (Hemel Hempstead: Wheatsheaf, 1989), ch. 10.

71 PRO CAB 134/641, Production Committee 'Draft Economic Survey, 1949', 17 Jan. 1949, paras. 58, 70; Cairncross, *Years of recovery*, 448; the continued rise in investment is shown in Feinstein, *National Income*, Table T5.

72 L. Robbins, 'Inquest on the economic crisis', *Lloyds Bank Review*, Vol. 6 (1947), 11.

73 Hicks, 'Empty Economy', 9. Note, however, that some economists dissented from this view from a strongly laissez-faire perspective: Viner, 'American view'; J. Schumpeter, 'English economists and the state managed economy', *Journal of Political Economy*, Vol. 57 (1949), 371–82.

policy principles be postponed in present circumstances if it could be postponed without catastrophe'.[74]

Britain's claim for Marshall aid, after stressing the importance of investment, went on to argue that 'a careful balance between this and other objectives must be maintained. Excessive home investment might defeat its own ends; it would endanger stability, require more imports than can be afforded, and sharply limit exports'.[75] This view of investment and the dilemmas of British economic policy it encapsulated was endorsed by the United States, by economists of all persuasions, and also (reluctantly) by the main employers' organisation, the Federation of British Industry.[76] This may be said to have been an acceptance of the logic of dealing with the shortage economy as it existed in the Britain of the late 1940s.

## VI

Marshall aid sustained the Attlee government in its pursuit of a strategy that faced many obstacles. The tight rein on consumption generated considerable political opposition, and also, by its effects on incentives, threatened the drive for greater output and productivity. Investment was booming, and government attempts to control it in the initial period after 1945 were seriously ineffectual. The strain on the balance of payments was addressed by the high priority given to exports, but this exacerbated the tensions arising from directing resources away from consumption. Without Marshall aid the pressure on the government to change policies might have become irresistible, with incalculable consequences. Whatever the aims of Marshall aid, for Britain it made possible a strategy of giving priority to exports and investment, which might otherwise have been politically, and perhaps economically, unsustainable.

Rather than Marshall aid rescuing the Labour government from its excessive enthusiasm for welfare or nationalisation, it would be more accurate to say that the aid saved the government from the consequences of its excessive holding down of consumption. This stemmed in part from a dangerous enthusiasm for investment, particularly in 'Department One' industries, that is production of means of production rather than of consumption. (See CAB 134/437 priority list for investment, where low priority are consumer goods industries, high priority are export and machinery industries.)

The strategy also embodied a distrust of the price mechanism, which if allowed to operate would have pulled more resources into consumption industries, while if applied in the public sector would have reduced the demand for resources in the coal and electricity industries, which may be seen as primarily investment goods industries.

74 J. Meade, *The Cabinet Office diary 1944–46*, ed. S. Howson and D. Moggridge (London: Macmillan), 202, 275–6, 294.

75 PRO CAB 134/234, 'Draft Long-term Programme', para. 149.

76 R. Harrod, *Are these hardships necessary?* (London: Hart-Davis, 1947), 28–32; PRO CAB 134/212, Economic Planning Board, Mins., 11 Feb. 1949.

This predilection for investment, particularly in the production of means of production, and the distrust of the price mechanism illustrate the importance of a particular economic ideology in informing policy in the 1940s. This may be called a 'productionist socialism', which in turn tended to create or at least reinforce the shortage economy aspect of Britain in these years and hence the parallels with the erstwhile socialisms of Eastern Europe, until, in the former case, the situation was retrieved by Marshall aid.[77]

[77] This comparison is discussed in M. Chick, *Industrial policy in Britain 1945–51* (Cambridge: Cambridge University Press, 1998), ch. 9.