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BACKGROUND CASE NOTE

LESSONS FROM THE MARSHALL PLAN^{*}

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Lessons from the Marshall Plan

The Marshall Plan is invoked whenever policy makers contemplate large-scale foreign aid. A cursory Google search turns up and “A Marshall Plan for Africa,” “A Marshall Plan for Haiti,” “A Marshall Plan for Eastern Europe,” and “A Marshall Plan for the East.”¹ The foreign aid program officially known as the European Recovery Program (ERP) – but forever associated with the name of Secretary of State George C. Marshall – is widely regarded as a singular success. Over the four years from 1948 through 1951, the United States transferred \$13 billion (roughly \$115 billion at current prices) to the war-torn nations of Europe. The transfer represented approximately 2 per cent of U.S. GDP and roughly the same share of the collective GDP of the recipient countries. The recipients, seemingly on the brink of economic collapse, mounted a strong recovery. Industrial production in the recipient European countries leapt from just 87 per cent of pre-World War II levels in 1947 to fully 135 per cent in 1951, a 55 per cent jump in just four years. At least as importantly, the resumption of growth was sustained. Europe embarked on a “golden age” of economic growth that spanned a period of decades.

No wonder, then, that the Marshall Plan is widely regarded as the most striking historical example of a successful large-scale foreign aid program.² And no wonder that there have been repeated attempts to identify the key ingredients of its success in the hope that this might be replicated in other times and places.

Grounds for Caution

But there are also good grounds for questioning whether the Marshall Plan in fact constitutes an aid technology that is readily transferred. To start, there are reasons to doubt the importance of American aid for Europe’s recovery.

- The difficult economic and political conditions of early 1947 reflected an exceptionally cold winter resulting in coal shortages and harvest failures. These exceptional conditions led contemporaries to overstate the gravity of the postwar crisis; with the end of this exceptional weather, agricultural productivity and economic productivity could return to more normal levels.³
- The low level of industrial production in Western Europe in 1947 was, in fact, a peculiarly German phenomenon. Production in the three Western zones of Germany (occupied by the U.S., France and Britain respectively) was only 34 per cent of 1938 levels, reflecting disorganized conditions, pervasive price controls, rationing, and ceilings

¹ The present author pleads guilty of having penned the last of these.

² J. Bradford DeLong and Barry Eichengreen (2003), “The Marshall Plan: History’s Most Successful Structural Adjustment Program,” in Rudiger Dornbusch, Willem Nolling and Richard Layard (eds), *Postwar Economic Reconstruction and its Lessons for the East Today* (Cambridge, Mass: MIT Press).

³ This revisionist view has been influentially advanced by Alan Milward (1984), *The Reconstruction of Western Europe, 1945-51* (Berkeley, Calif.: University of California Press).

placed by the occupying powers on the output of strategic sectors like iron and steel. When Germany is removed from the European aggregate, output was already 105 per cent of 1938 levels in 1947. Europe, in other words, was already on the road to recovery. Once ceilings on the output of its strategic sectors were removed, Germany could recover as well.⁴

- The European economy was already highly developed. It is further argued that with the resumption of investment in plant and equipment, Europe was perfectly capable of growing under its own steam. In fact the vast majority of investment during the Marshall Plan years was financed out of Europe's own savings, not by U.S. aid.⁵
- While the Marshall Plan, by providing dollars, helped to relax import bottlenecks, those bottlenecks were severe for only for a minority of European industries. Relaxing bottlenecks mattered for the cotton textile industry, for example, given that little cotton was grown in Europe itself.⁶ The question was whether this mechanism mattered more generally.⁷
- The Marshall Plan helped to compensate for governments' lack of fiscal resources. It thereby helped to finance critical infrastructure repair. But, notwithstanding propaganda photos of roads, bridges and ports that were reconstructed using U.S. aid, the fact of the matter is that U.S. funds, at less than 2 per cent of the recipients' GDP, were small relative to the domestic resources mobilized through the fisc to repair infrastructure, housing stock, and industrial capacity.⁸
- Even the process of European integration, which the Marshall Plan is credited with stimulating, was already highly developed. There existed a long line of Europeans, from John Locke to Jeremy Bentham to Jean-Jacques Rousseau, for whom deeper European integration had been regarded as an ideal.⁹ The Marshall Plan encouraged the idea of European integration but it did not introduce it.

Thus, while modern scholarship does not deny the importance of the Marshall Plan, it argues that U.S. aid made only a modest contribution operating through these channels – which were the ones emphasized by contemporary analysts and the architects of the plan themselves.

⁴ Helge Berger and Albrecht Ritschl (1995), "Germany and the Political Economy of the Marshall Plan 1947-1952: A Re-Revisionist View," in Barry Eichengreen (ed.), *Europe's Postwar Recovery* (Cambridge: Cambridge University Press).

⁵ Barry Eichengreen and Marc Uzan (1992), "The Marshall Plan: Economic Effects and Implications for Eastern Europe and the former USSR," *Economic Policy* 14 (April); Frances Lynch (1997), *France and the International Economy from Vichy to the Treaty of Rome* (London: Routledge).

⁶ Cotton was grown in Turkey, partly a European country and a Marshall Plan aid recipient, but not more generally.

⁷ DeLong and Eichengreen, op cit. A dissenting view for Germany is Knut Borchardt and Christoph Buchheim (1991), "The Marshall Plan and Key Economic Sectors: A Microeconomic Perspective," in Charles Maier and Gunter Bischof (eds), *The Marshall Plan and Germany* (Oxford: Berg).

⁸ DeLong and Eichengreen, op cit. See also Charles Maier, "The Two Postwar Eras and the Conditions for Success in Twentieth Century Western Europe," *American Historical Review* 86 (1981), pp.87-122.

⁹ And much of Western Europe had been integrated economically, de facto and for better or worse, under Germany during World War II.

Grounds for Optimism

At least as important, modern research suggests, was the political impact of the Marshall Plan. The United States made cooperation among the recipients a precondition for the extension of aid. Those recipients were required to create an institution, the Organisation for European Economic Cooperation (the for-runner to today's OECD) to jointly formulate plans for the utilization of aid. That encouragement in turn helped them to proceed down the road to European integration. With regional institutions like the European Coal and Steel Community to jointly monitor the production and use of strategically important coal and steel, it became possible to lift ceilings on these key German industries without seeming to threaten the security of the country's neighbors. Given Germany's status as the home of many of Europe's heavy industries, which in turn provided inputs to its critical capital goods producing sectors, lifting those ceilings was important not just for German economic recovery but European economic recovery more generally. With the creation of the European Payments Union with \$500 million of seed money from the Marshall Plan, it became possible for countries to move cooperatively toward the relaxation of exchange controls. And given the importance of intra-European trade, relaxing those controls in turn contributed importantly to European recovery.

U.S. aid also came with conditions attached, not unlike those attached to modern structural adjustment loans. Governments were required to balance budgets, stabilize exchange rates, and remove distortionary price controls. The Marshall Plan at the same time provided finance to at least partially fill the budget gap. It thereby reduced the amount of belt tightening required of the recipients, facilitating political compromise. With the move toward budget balance and the reduction in inflationary pressure, it became possible to relax price controls. And with the relaxation of price controls, goods flooded back to the market.

Thus the modern scholarly consensus, such as it is, does not deny the success of the Marshall Plan. But it suggests that the story behind that success is subtler than the one told by contemporary propagandists.

The objectives of the Marshall Plan, it is important to emphasize, were as much political as economic. The goal of the United States was to prevent the collapse of economic activity in Europe due to perceived shortages of fuel, food and industrial raw materials. It was to encourage the repair of infrastructure and the housing stock in order to jump-start economic growth. But it was also to help quell social unrest and contain the political influence of political parties hostile to economic liberalization and the reconstruction of a market economy. To be sure, U.S. policy makers sought a Europe that would provide a buoyant market for American exports. But against the background of the Cold War, and with powerful socialist and communist parties in Western European countries, they also sought to prevent the continent from falling into the Soviet camp.

Ingredients of Success

So what made the Marshall Plan a success? Close scrutiny suggests several elements, several but not all of which will be difficult to replicate elsewhere.

Recipient input. The allocation of aid under the Marshall Plan relied extensively on recipient input. From the outset the Economic Cooperation Administration, operating through the OEEC, invited each participating country to submit a plan of action describing how it would

use donated resources so as to reach a position where aid could be terminated in 1952-3. Consultation between the ECA on the one hand and the OEEC and participating governments on the other was ongoing and continuous, and the composition of U.S. aid was modified in light of the information and requests it received from the recipients.

Decentralization. Disbursement and administration of aid was extensively decentralized. There was both a head office in Washington, which interacted with American lawmakers, and an operational office in Paris, which interacted with European governments.¹⁰ In Washington, the head of the Economic Cooperation Administration, Paul Hoffman, delegated significant authority to his assistants, who in turn delegated it to desk officers, branch and division chiefs and special consultants. In Paris, the U.S. Special Representative, first W. Averell Harriman and then Milton Katz, dealt with national governments through country teams attached to national embassies. Administrators encouraged the flow of information from the field to headquarters and adapted program guidelines in response.¹¹

Public-private partnerships. The ERP relied on private channels rather than governments for procuring resources. It operated with the participation of business representatives and private advisory committees, in which industry and labor representatives collaborated with senior civil servants.¹²

Encouragement of Competition. A basic tenet of the Marshall Plan was the encouragement of competition as a device for boosting economic and productivity. U.S. administrators believed in encouraging free competition and discouraging monopolies and market power (even more so abroad than at home, where the principle was sometimes honored in the breach). But they pursued their objective in pragmatic rather than doctrinaire ways.¹³ Where the recipients cited strong social or other traditional arguments for limits on competition, the donor was prepared to bend.

Regional coordination. The United States insisted on a collective and unified approach to the allocation of aid that encouraged the recipients to think about the spillover effects, both positive and negative, of their use of donated money, and in order to minimize overall dollar demands on the United States. The U.S. emphasized the institutionalization of regional cooperation – specifically, the creation of standing organizations through which cooperative initiatives could be carried out, first the United Nations Economic Commission for Europe and then the OEEC. The provision of Marshall Aid to seed the European Payments Union (as mentioned above) as a vehicle for containing the balance-of-payments problems that arose in the course of current-account liberalization was also critically important in this regard.

Auto-extinguishment. The Marshall Plan was self-extinguishing. It was set up as a four-year program and implemented by a temporary government agency rather than as a program of the U.S. State Department. Influential politicians like Senator Robert Taft insisted on this in

¹⁰ The ERP rested on treaties signed with each of the 16 participating nations (including the German Bizone, which was not yet sovereign).

¹¹ Harry Bayard Price (1955), *The Marshall Plan and its Meaning* (Ithaca, NY: Cornell University Press).

¹² Michael Hogan (1987), *The Marshall Plan: America, Britain and the Reconstruction of Western Europe, 1947-1952* (Cambridge: Cambridge University Press).

¹³ Price, *op cit.*, p.341 and *passim*.

order to prevent the United States from becoming permanently entangled in Europe.¹⁴ But the fact that the program had a clear ending date encouraged the recipient to ponder “life after aid” and limited the danger of aid dependence.

Strong institutional capacity. Above all, the European recipients had relatively well-trained and educated labor forces. There had been extensive wartime destruction of industrial capital stock and other productive capacity, but there had also been extensive wartime investment. Property rights and rule of law were well established. All this was of particular advantage. It positioned Europe to make the most of donated resources.

Implications

The Marshall Plan deserves its reputation as the most successful large-scale foreign aid program of modern times. Foreign aid supported European recovery in the difficult aftermath of World War II. Conditionality focused on balancing budgets, stabilizing exchange rates and liberalizing prices where these remained under government control, but it did not require precipitous or blanket liberalization. U.S. conditionality encouraged liberalization and competition but did not require *laissez faire*. U.S. policy makers permitted and even sometimes encouraged European governments to remain involved in other aspects of economic management. The recipient governments continued to formulate indicative plans (France) and operate state holding companies (Italy) in order to coordinate complementary investments and solve other coordination problems that decentralized markets, left to their own devices, could not. They developed tax and transfer policies and wage guidelines to maintain what Europeans regarded as a socially acceptable distribution of income and to foster social cohesion.¹⁵

Unusually for this kind of foreign aid program, the Marshall Plan actively encouraged, indeed required, collaboration and steps in the direction of economic and financial integration on the part of the recipients. It help to set Europe on the road of regional integration, a path that ultimately rendered another European war inconceivable – thereby illustrating how foreign aid can reduce the risk of inter-state violence.¹⁶ The European project to which the Marshall Plan contributed shaped elite expectations of how European governments should behave but transformed still more fundamentally popular expectations of the same.¹⁷

Imagining how different Europe would be in the absence of the Marshall Plan is a formidable – indeed probably an impossible – exercise in counterfactual history. That said, there are important reasons to believe that the Marshall Plan made a difference.

¹⁴ See Robert Latham (2001), “Cooperation and Community in Europe: What the Marshall Plan Proposed, NATO Disposed, in Martin Schain (ed.), *The Marshall Plan: Fifty Years After* (London: Palgrave).

¹⁵ Barry Eichengreen (2007), *The European Economy since 1945: Coordinated Capitalism and Beyond* (Princeton: Princeton University Press).

¹⁶ The Marshall Plan also had a second legacy, namely hardening the divisions of the Cold War (encouraging a definitive “iron curtain to descend over Europe” (Churchill’s words) – although the U.S. did in principle invite the Eastern bloc, including the Soviet Union, to participate (an approach that was rejected).

¹⁷ Using Marshall Plan money, U.S. administrators actively encouraged the notion of a harmonious Europe whose national governments worked together. Among their tools were propaganda films and poster campaigns, where popular images included a single European ship sailing under a collection of European flags and a single European windmill, with a different national flag on each blade. This new imagery came to be accompanied, with time, by a new reality.