The Marshall Plan

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Abstract

The Marshall Plan transferred over US$12.5 billion to Western European countries between 1948 and 1951. This note contrasts the main views on its impact on the post-war European performance. I conclude that, although the direct impact of the plan through private and public investment was rather limited, Marshall Aid provided the recipient economies with a temporary solution for the severe dollar constraint that posed a threat to the continuation of the European miracle. Furthermore the Plan played an important role promoting collaboration among former adversaries.

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In Europe during World War II the productive effort of more than an entire generation was lost with per capita income returning to the levels of the turn of the century. This fall in output reflected not only the destruction of capacity but also the disruption of channels for obtaining inputs and distributing production. The reconstruction process began right after the war with industrial production reaching pre-war levels as soon as 1947. The weather conditions in 1947 substantially depressed agricultural yields leading to important food and energy shortages. The substantial trade deficits of the recovering economies combined with the negative experience of international investors after World War I lead to a "dollar gap" that posed a threat to the continuation of the European miracle.

These were the circumstances that surrounded the development of the Marshall Plan, officially the European Recovery Program (ERP). The views on the motivations behind the ERP range from plain American imperialism (Kolko and Kolko (1972)) to pure altruism; in the words of Galbraith (1998) "the primary purpose of the Plan was compassionate good will, the notion that our former allies needed to have the help of the US". Nonetheless most of the literature acknowledges that, beyond the concern for former allies, the political and social stability of non-Communist Europe and the continuity of export markets for US products were two of the main concerns of the Truman administration.

The initial Plan proposal was presented in June 1947 by Secretary of State George Marshall, asking European governments to design a coordinated aid program to be funded by the US. The offer included the Soviet Union and its allies but the conditional terms on economic collaboration and disclosure of information guaranteed that the Soviet Union would never accept it. In response to the American offer the final aid recipients, Austria, Belgium, Denmark, France, West Germany, Great Britain, Greece, Iceland, Ireland, Italy, Luxembourg, the Netherlands, Norway, Sweden, Switzerland and Turkey formed the Organization for European Economic Cooperation (OEEC) to coordinate a proposal based on national needs and consistent with American objectives on trade and economic cooperation between recipient countries. US President Truman signed the Plan into a law on April 3, 1948 establishing the American-led Economic Cooperation Administration (ECA) to administer the program.

Over the four years that followed its approval by Congress, the Plan transferred $12.5 billion of US aid to Western Europe. The allocation of funds did not follow a simple rule although it was mainly determined by the dollar balance of payment deficits of the recipient economies, taking also into account geopolitical considerations especially in the cases of France and the UK. Marshall Aid represented 2.1% of American GNP in 1948, rose to 2.4% in 1949 and then fell to 1.5% in the remaining two years. In terms of national income of the recipient economies, the funds ranged from 0.3% per year for Sweden to 14% for Austria. For the large Western European economies it represented an average yearly transfer of 2.5% of GDP for France, 2.2% for Italy, 1.3% for the UK and 1.2% for Germany.

The OEEC took the leading role in allocating funds conditional on the approval of the ECA. The American supplier was paid in US dollars, which were credited against the ERP account corresponding to the European buyer. This buyer paid for the American imports in local currency, which was deposited by its own government in a counterpart fund. These additional resources were used for local investment projects and eventually were absorbed into the recipient's national budget.

The impact of the plan on the European recovery is not free of controversy. On the one hand, early triumphalist accounts (Jones (1955), Mayne (1970), and Arkes (1972)) describe the Plan as vital for the reconstruction of productive capacity, the development of the necessary institutions for cooperation among former adversaries, and the restoration of the European confidence in market capitalism. In the words of Mayne (1970), Marshall Aid "was a precondition of all later affluence and economic miracles, as well as moves toward European unity". On the other hand, Milward (1984) discounts the importance of ERP transfers arguing that the recovery was well under way before 1948 and the reconstruction of the damaged private and public capital stocks was almost completed. Somewhere in between, De Long and Eichengreen (1993) argue that Marshall Aid helped the recipient economies more in terms of political economy than macroeconomics. The ERP bought European governments the political space needed to avoid the attrition wars that characterized the interwar period allowing an institutional environment conducive to growth.

Until the influential work of Milward (1984), the literature agreed on the vital importance of the ERP funds for Western European growth. According to this view Marshall Aid allowed for the reconstruction of the capital stock, the elimination of bottlenecks that obstructed production, the public provision of infrastructures and the surge in intra-European trade. In the words of Arkes (1972) "the plan was critical at the margins having a multiplier effect of three or four times its value". A superficial analysis of the data suggests that this view is exaggerated. If one computes the growth rates of per capita GDP for the recipient economies one finds that in the three years that preceded the ERP yearly growth averaged 6.5%, during the Plan it averaged 4.4%, falling to 4% between 1953 and 1956. Eichengreen et al. (1992) argue that if the effects of the Plan worked mainly through private and public capital accumulation there should be a significant correlation between output growth and ERP allotments as a share of GDP across recipient economies. Contrary to this view their statistical analysis does not turn up a significant coefficient on Aid allotments. Alvarez-Cuadrado and Pintea (2008) present a two-sector neoclassical growth model with public capital to explore the direct impact of the ERP. Their numerical analysis suggests that the transfers increased the rate of private investment by less than one percentage point leading to no more than half a percentage point increase in the growth rate of output. Since average yearly transfers represented no more than half a year worth of post-war growth it is not surprising that the effects of the Plan through capital accumulation are rather limited. Along similar lines, Milward (1984) argues that the outstanding performance of Western European economies would have not been very different in the absence of the Plan. He discounts the direct impact of the Plan and convincingly documents that the leverage afforded by the ERP was insufficient for the US to force through its vision of the United States of Europe. In Milward's view the primary role of the ERP was limited to sustain the flow of capital imports necessary to prolong the recovery.

In a different spirit, De Long and Eichengreen (1993) argue that political economy considerations lie behind the true impact of the Plan. Marshall Aid provided the currency needed to relax the foreign exchange constraint, giving European policy makers extra room to maneuver. This political space, together with aid conditionality, induced European governments to balance their budgets, restore internal financial stability, and maintain their commitment to free markets. Their counterfactual vision of Western Europe suggests a permanent influence of Communist parties, an expansion of government controls and regulations, and a resurgence of economic nationalism and isolationism. This argument, although it has its merits, does not seem to account for the variety of institutional arrangements present in the recipient economies. For instance, two of the fastest growing economies, France and Germany, adopted rather different growth strategies. The French economy was characterized by major involvement of the state in key economic sectors, while the German approach illustrates the growth potential of relatively free markets. In my view, although the functioning of the market mechanism was constrained in many countries as a result of war priorities, there was a tacit consensus that this was only a temporary interruption of the long European experience with free markets and therefore the influence of the Plan was rather limited in this respect.

To sum up, the direct impact of the Plan led to no more than one half of a percentage point of growth per year. Along the lines of Milward (1984), I believe the plan provided European governments the means to prolong the recovery process that began after the war. In some cases the transfers complemented export revenues, preventing a balance-of-payment crisis, while in others they only postponed their occurrence. The political economy argument is more difficult to evaluate, but given the prior European experience with free markets and the existence of a well developed system of property rights, it is difficult to fully accept the counterfactual scenario drawn by De Long and Eichengreen (1993). Finally the Marshall Plan played an important role by inducing British and French support for a strong Germany. Although the forces that led to the process of European integration responded more to internal political and economic developments in the European countries than to American pressure, the Marshall Plan helped promote collaboration among former adversaries.

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