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POST WAR ECONOMIC AND MONETARY RECONSTRUCTION
IN WESTERN EUROPE

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POST-WAR ECONOMIC AND MONETARY RECONSTRUCTION IN WESTERN EUROPE,

1944-1952

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1. Introduction

One of the aftermaths of World War Two was a tremendous imbalance between supply and demand. On the supply side, the hostilities had seriously undermined production capacity in Europe. Millions of people had been killed or wounded, while others had become desperately poor or were in bad health because of malnutrition and illness. To a large extent the means of production, houses, and means of transport had been destroyed; replacement and new investment had been postponed. The stock of cattle had decreased, fertilizer and fuel had become scarce, and much farm land had been flooded or damaged. This resulted in low productivity, low production and low exports.

On the demand side, the amount of money available was enormous. The war effort of Germany and the Allies had been financed largely on the money markets; the German nation had also used the money markets of the occupied countries. Thus after the war the purchasing power of the private sector was enormous, even as many people had become poor also. Apart of this, reconstruction had to be financed. The huge disequilibrium between low productive capacity on the one hand and increased money supply on the other hand led to high inflationary pressure and excess demand (see paragraph 2).

In theory inflationary pressure and excess demand can be neutralized in several ways. In the short term, a monetary purge or currency reform decreases excess demand drastically. However, it will only have a temporary success, because the purge does not eliminate the original cause of the increase in the money supply i.e. continuing government deficits in Europe. When the money supply has become excessive, a monetary reform may be seen as an essential step towards monetary equilibrium, although it will not be sufficient in itself. An excess of imports over exports will also drain the supply of money. In the longer term, an increase in production has the same effect; this solution coincides with an excess of imports where the imports are used for purposes of production. However, foreign deficits are only possible so long as international reserves, possibilities of monetization of investments abroad and of foreign assistance are not exhausted. Price increases and rationing will frustrate inflationary pressure too; these, like currency reforms, have the disadvantage that they do not affect the roots of the problem of an excessive money supply.

During the postwar reconstruction the disinflation policies mentioned above were implemented in Western Europe. Many countries introduced currency reforms and all countries used trade-balance deficits as a means of stimulating production. Some countries, notably Italy and France, did not control prices to the same extent as the others, which also applied rationing controls. The excess of imports in most countries of Western Europe was activated by an overvaluation of currency. This policy made imports cheaper and in this way prevented price increases; the policy also discouraged exports, thereby stimulating the balance of payments deficits. In order to limit these deficits, trade and exchange controls were applied; with the exception of Belgium, which abolished many import restrictions soon after the cessation of hostilities. All Western European countries, moreover, were forced to pursue a bilateral balance of payments equilibrium,

because of scarce foreign currencies and the absence of multilateral clearing. This bilateralism, together with the absence of the Eastern European and German markets, hindered trade and made Western Europe more dependent on non-European markets, especially the United States¹.

State intervention in Western Europe became normalized after the second world war. The classic economic view of a spontaneously developing equilibrium had seemed to be inadequate during the Interbellum; instability and inflexibility on various markets had crippled the effects of the classical economic tools. After the war a strong desire existed in most countries to build a new society in a new way. Governments began to plan, nationalize and invest in order to reconstruct the economy. Programs for the redistribution of wealth were started to allow labourers a share: social security was improved, taxes made more progressive, and even some participation in decisions of national and company interest was instituted. The new economic theory of John Maynard Keynes with its emphasis on demand management fitted in perfectly with this new desire for state intervention. In a way Keynesianism became the postwar legitimization of state action, although Keynes did not prescribe the control system that was initially applied by many countries initially. This state action was inward looking and resisted influence from outside that would affect the planned reconstruction. Consequently there was opposition to American action in restoring free trade as soon as possible, although the aid offered by the Americans was gladly accepted².

¹ The Western European countries each had their own political and economic ends and followed separate paths of recovery. The only important European trade agreement until 1952 was the European Payments Union (EPU) in 1950, a multilateral payment scheme that was started with working capital provided by the United States. This country was interested in free trade; it feared trade discrimination that could result from European bilateral trade agreements and deficits. This idea dominated its foreign policy, which was primarily anti-colonial, open door-minded and favoured world wide trade liberalization and multilateralism. The increase in trade possibilities was one of the aims of US efforts to improve multilateral cooperation in Western Europe. For instance immediately after the war the United Kingdom and France were offered credit, if they agreed to cooperate in establishing a new mechanism of multilateral trade throughout the world. The Bretton Woods agreement was also part of this policy, as was the Marshall Plan.

² Because there was no agreement about the economic and political future of Germany, Allied policies concerning Germany were indecisive in the early postwar years; recovery for instance was extremely sluggish due to the division of the country into four occupation zones. The important northwestern zones were designated as dollar zones. Thus Western Europe was deprived of German coal, steel and capital goods exports, because of low German production and dollar shortages. After the beginning of the Cold War hostility to Eastern Europe also altered the pattern of trade; relatively more food products had to be imported from outside Europe.

One of the most urgent problems facing most European countries was an excess of liquidity. For this reason in the period 1944-1952 twenty-four currency reforms were executed in order to cut the money supply. Some of these decreased purchasing power drastically, while others had only less severe effects. We will concentrate on the different types of reform that were applied throughout Europe. One specific country will be used as example of each type of reform: the Soviet Union, Belgium, and West Germany (see paragraph 3). However, in most countries excess demand did not disappear; rather was stimulated by the reconstruction effort, which mostly had to be financed on the money and capital markets. In some countries this necessitated a repetition of the currency reform (see table 1).

Because of low productive capacity the reconstruction effort also resulted in high imports and a huge deficit on the current account of the balance of payments, especially vis-a-vis the United States. A so-called dollar shortage existed that ultimately led to the implementation of the European Recovery Program (ERP) or Marshall Plan, which was primarily a program of American aid in kind. Like the currency reforms, the Marshall Plan was an important moment in reconstruction. The discussion on the need for the ERP has been reopened by Alan S. Milward. I shall use this discussion as my point of departure in reviewing the economic reconstruction policies that were carried out in Western Europe (see paragraph 4). Eastern Europe, under the guidance of the Soviet Union, chose another road to recovery. Because it is not of interest for the postwar reconstruction of the Netherlands, the Eastern European situation will not be analysed, except for the types of monetary purges that were implemented, which were not limited to Eastern Europe.

Gradually reconstruction in Western Europe advanced. In the dominant western economic view this meant that market forces had to be strengthened again. This resulted in devaluation, the third important moment in reconstruction, and in the abolition of most control systems in the late forties and early fifties (see paragraph 5). These measures symbolized the end of recovery and the start of economic expansion, which were so successful in the 1950s and 1960s.

2. Causes of excess liquidity in Europe

After the war all European countries experienced an excess of liquidity that endangered normal price movements. Germany had imposed war expenditures on the occupied countries, especially in Western Europe, and these countries had incur debts at home. They had financed about 12% of the German expenditures of approximately 700 billion

Reichsmarks during the period 1939-1945³. The forced payments even exceeded the sum of German tax receipts in the years 1943 and 1944 together.

To begin with, the occupied countries had to pay occupation costs. The compensation for the stationing of troops had been increased during the war years. The growing costs had to be financed on the money and capital markets of the occupied countries. Furthermore, contributions had to be made to the German war effort in Eastern Europe. The commodity trade imbalance between exports to and imports from Germany increased. The exports were not all paid for. In addition to this extortion, Germany, in order to increase the war contribution of the occupied territory, had decided to overvalue the Reichsmark in relation to foreign currency. The exchange rate for the French franc for instance was overvalued by roughly 50%⁴.

Germany had also extorted a great deal of money from Belgium. During the first phase of the occupation Germany introduced a so-called spearhead currency in the occupied countries, the Reichskreditkassenscheine, which could not be used in the country itself. It considered the Kassenscheine as legal tender and used them to spend as much as was thought necessary. The Belgian monetary authorities, however, considered the new currency a threat to the economy. The bank of issue in 1941 successfully started the exchange of Kassenscheine for francs thus reducing the amount of spearheadcurrency in circulation. The bill of 4.3 billion francs was presented to the Treasury. In the commodity trade almost the same happened. Because of the war effort German imports increased while exports decreased. In exchange for a claim on Germany, the Belgian state was forced to furnish Germany with francs to finance the occupation the Belgian credit amounted to 62.7 billion francs⁵. The occupation costs paid to Germany were 67 billion francs⁶. Nominal purchasing power had risen to a more than threefold,

³ Karl-Heinrich Hansmeyer and Rolf Caesar, *Kriegswirtschaft und Inflation (1936-1948)*, page 402. Angus Maddison in *Economic Policy and Performance in Europe 1913-1970* on page 467/8 even thinks that it was 104 billion Reichsmarks.

⁴ Alan S. Milward, *War, Economy and Society 1939-1945*, page 137. Charles P. Kindleberger, *A Financial History of Western Europe*, page 104.

⁵ Léon H. Dupriez, *Monetary Reconstruction in Belgium*, page 4.

⁶ Altogether the costs were 140.1 billion francs, including indemnities to German nationals (340 million francs), costs of the billeting of German troops (5.8 billion francs), the export surplus, and the amount of Reichskreditkassenscheine. See Léon H. Dupriez. page 5.

to 164.3 billion francs⁷. The total of state expenditures in Belgium during the four years of occupation was 160.9 billion francs, a multiple of the expenditures in the four years before the war. State income during the war came to 68.5 billion (3.4 billion francs because of the issue of small coins included), which left nearly 91.6 billion francs to be financed otherwise. Only 5.2 billion of this was obtained through long term loans, 13.9 billion through Treasury bills, and 72.5 billion through medium and short term loans. The latter could be converted by the holders at an inconvenient moment for the State. As a comparison, in 1938 the government had a debt of 44.9 billion francs. All this meant that the liquidity of the private sector in Belgium had reached the level of 240 billion francs; in 1938 this had been 54.2 billion. Because production had fallen to far below normal, excess liquidity was enormous.

When Germany had been beaten and the occupied nations had obtained control over their own territory again, a great deal of recovery spending had to be done. In all Western European countries the reinstalled authorities were also expected to be generous in furnishing the Allied troops with local currency for which they would later be compensated. This further increased liquidity.

The monetary situation in Germany was much the same. Although a great deal of money had been extorted from the occupied countries, and taxes increased at home, 55% of the German war efforts had been financed by means of internal debts. The German administration had suppressed inflation by a system of price and wage control, and rationing, which they had introduced in other countries as well. From 1944 on, the effectivity of the control system had decreased. Because of this the trust in the Reichsmark (RM) disappeared. Inflation was to appear when production declined and purchasing power increased⁸. This resulted in rising black market prices. When the German Reich collapsed, excess liquidity was tremendous. The sum of all liquidities amounted to RM 300 billion, a multiple of the situation before the war; the money supply came to RM 73 billion, saving deposits to RM 125 billion and other bankdeposits to RM 100 billion. The division of the Reich decreased the excess liquidity in the three western zones to RM

⁷ Léon H. Dupriez, page 6. He defined the nominal purchasing power as the sum of small coins and notes, National Bank notes, Luxemburg notes, current accounts of the central bank, accounts of the post-check system and the current accounts in banks. This definition of purchasing power is used only in relation with Belgium.

⁸ Production declined because of damage caused by the war, and because of the physical condition of the German population. The division of Germany into four zones, forced deliveries to other countries, the almost complete isolation from world trade, the decrease of the number of officials, and the removal of important managers played an important role as well.

173 billion in the spring of 1947⁹.

More and more the Reichsmark ceased to be unit of account, store of wealth and means of payment, except for the purchase of the official rations. Nevertheless, a currency reform was not executed by the Allies¹⁰; the German economy therefore rapidly became a barter economy:¹¹

... individuals and business firms acquired most of the commodities they wanted by exchange against commodities they had to offer, and a whole series of exchanges were sometimes necessary to obtain the desired commodity. Every firm had several specialists, called "compensators", on its staff. If, for example, cardboard for packing was needed, the compensator might be obliged to barter the plant's own products for typewriters, the typewriters for shoes, and the shoes for cardboard."

Firms also had to pay their employees in kind. Thus coal miners were paid partly in coal. This enabled the miners to barter coal for food and other desired consumer goods.

All normal economic incentives had ceased to work. Exports were not profitable as long as they were determined by dictated internal prices. Imports did not stimulate the restoration of the economy either, because imported goods immediately disappeared from the official market, and were hoarded as 'wertbeständige Güter', or sold at the black markets. Employees were not interested in more money, so higher wages to encourage productivity did not work either. Absenteeism for one or two days a week was more interesting for the employees because that saved them time to cultivate food themselves, and to barter books, appliances, lamps, and the like for food, especially in the bad winter of 1946/7 and after the poor harvest of 1947.

The Soviet Union had to deal with the same problems as Germany. Even before the war the production of consumer goods was insufficient to satisfy the purchasing power of the population because of planning problems; the production of consumer goods was nearly always smaller than planned, income payments were not. The war effort and the dominance of war-production worsened this imbalance. Furthermore, the

⁹ Deutsche Bundesbank, *Währung und Wirtschaft in Deutschland 1876-1975*, pages 418-419. In the middle of 1939 the money supply was RM 11 billion (page 417), in the middle of 1936 it was RM 6.35 billion.

¹⁰ The four Allies disagreed on several points. This delayed the currency reform for at least two years.

¹¹ F.A. Lutz, *The German Currency Reform and the Revival of the German Economy*, page 122.

debt of the State increased in spite of the imposition of a special direct war tax and the intensification of the drive for more money through the sale of government bonds, and through contributions to defense funds and voluntary donations to the State. Soviet banks supplied the money to cover the deficits. Inflation was more or less suppressed by a rationing system that also distributed many scarce products¹². The government also allowed one free market where farmers were allowed to sell their surplus products. Purchasing power therefore found its way to the open market, not to a black market. As a supplement to this 'kolchoz market', and as one of the measures against the money overhang, the government decided to open nonration or commercial stores in 1944¹³. These stores sold the same consumer goods as the ration stores, as well as a number of others, at prices that were considerably higher.

After the war the special war tax was abolished. The collection of voluntary donations and the contributions to the defense funds had to be ended as well. State expenditures, however, could not be reduced because of the reconstruction that was needed; vast areas of the Soviet Union for instance had been devastated during the war. For this reason excess liquidity increased. This meant that the monetary problems, caused mainly by the war, were not over yet.

3. European currency reforms

The excess liquidity was a big problem for the reconstruction effort. The danger of a huge inflation was immanent. Many countries therefore decided to cut the money supply drastically. Of the countries that participated in the war only the United Kingdom and Italy did not make use of a monetary purge.

The currency reforms of course differed in form and had various degrees of success; Poland, France, Austria, Hungary, Bulgaria and Rumania had to repeat the reform. John Gurley made a typology of European currency reforms that is useful for this exposé. He distinguished three different types (see table 1).

¹² Paul A. Baran, Currency Reform in the USSR, page 198, estimates that price rise from 1940 to 1947 was 202%.

¹³ Fritz Grotius, Die europäischen Geldreformen nach dem zweiten Weltkrieg, page 319/20. During the war also the so-called commission stores came into existence. They mainly bought and sold used consumer goods. Producer-cooperative stores existed too; they sold handicraft products and repairs. Both kind of shops charged prices on the same level as the nonration stores.

Table 1-Classification of European currency reforms

country	month and year of reform		type		
			1	2	3
Belgium	October	1944		x	
Greece	November	1944	x		
Poland 1	December	1944		x	
Yugoslavia	April	1945			x
France 1	June	1945		x	
Austria 1	July	1945		x	
Denmark	July	1945		x	
Norway	September	1945		x	
Netherlands	September	1945		x	
Czechoslovakia	October	1945		x	
Austria 2	November	1945		x	
Hungary 1	December	1945	x		
Finland	December	1945		x	
Hungary 2	August	1946		x	
Bulgaria 1	May	1947		x	
Rumania 1	August	1947			x
Austria 3	November	1947	x		
USSR	December	1947	x		
France 2	January	1948		x	
West Germany	June	1948			x
East Germany	June	1948			x
Poland 2	October	1950	x		
Rumania 2	January	1951		x	
Bulgaria 2	May	1952		x	

Source: John G. Gurley, *Excess Liquidity and European Monetary Reforms 1944-1952*, page 80.

Firstly there were the money purges that reduced the supply of liquid assets through the exchange of old banknotes and bankdeposits for new ones at rates below one. No blocking measures were taken to support the cut in liquidity and the economic subjects were free to spend the remaining money. This type of reform was introduced by the two European countries that experienced inflation of more than a 50% price rise a month, namely Greece (November 1944) and Hungary (December 1945). Later on the USSR (December 1947) followed, imitated by Poland (1950) Rumania (1952) and Bulgaria (1952). In Eastern European countries the currency reform was used against the capitalists and for the collectivization; unfavorable conversion rights were given to

independent farmers and entrepreneurs¹⁴.

Within this type of currency reform differences occurred in 1) the rate of exchange accorded between old and new currency; 2) the exchange right permitted to holders of various types of liquid assets, for instance to holders of bankdeposits in contrast to holders of banknotes; 3) the exchange rights granted to owners in possession of differing amounts of liquid assets. This last aspect shows the redistributive effect that countries, especially in Eastern Europe, sought to achieve by giving large asset holders unfavorable terms on which their old assets could be exchanged. The fourth difference was the rate of exchange permitted looking at the identity of the owner of the assets.

The identity of the subjects was not important in the currency reform that was applied in the USSR in December 1947¹⁵, although a similar effect was reached by a combination of the former three measures. The exchange rate of conversion was fixed at ten old rubles to one new ruble. Deposits of individuals at banks and saving institutions were exempted from this rule. They were converted following a sliding scale: credit balances up to 3.000 rubles at par, the next slice to 10.000 rubles at three rubles to two, and balances above 10.000 rubles at two old rubles to one new ruble. Nearly all public debt was decreased to one third. The deposits of cooperatives and collective enterprises depreciated from five old rubles to four new ones. The motivation behind this discrimination in favour of these production units was that they used their deposits more for production ends than for consumption ends¹⁶. Current income of Soviet citizens such as wages and pensions was not depreciated, but money in transit such as money orders and bank transfers was subjected to the same conversion ratio as normal money: ten to one. This currency reform was accompanied by the abolition of the rations, and by changes in the prices of consumer goods.

The farmers were the most affected, because cash on hand was hit hardest. In the period before they had accumulated large amounts of money at the kolchoz market. The other sections of the population had not been able to spend much of their income on food and other consumer goods because of the rations and the scarcity in the nonration stores. The kolchoz market therefore was the most important place where they could satisfy their consumer needs. The farmers who could not spend

¹⁴ In Bulgaria (1952), Rumania (1952) and Czechoslovakia (1953) also blocked accounts representing compensation for nationalized property were written off (see Edward Ames, Soviet Bloc Currency Conversions, page 339, note 2).

¹⁵ In 1947 the supply of consumer goods had been improved very much. That is why the Soviets thought the end of 1947 to be the first opportunity to abolish rationing and to drain the money supply.

¹⁶ Charles Bettelheim, *La Réforme Monétaire Soviétique*, page 342. See also Fritz Grotius, pages 319-323, and Paul A. Baran.

their money in the other shops either, took most of it home, and lost a huge part of it during the currency reform. The others, who had hoarded less money and had deposited more in the banks, were less affected.

In a second type of currency reform a portion of the supply of liquid assets was immobilized by blocking. The banknotes were called in and put on bankaccounts, which together with the other deposits could not be used. Only giro transfers to a limited extent were allowed. All assets were valued at par but only a small portion could be exchanged for new currency (see table 2). The deblocking of the remaining deposits was a process that took years.

Some currency programmes of this type were limited in scope. In France (January 1948) blocking provisions were employed for 5000 franc notes only, in Finland (December 1945) for 500, 1000 and 5000 mark banknotes¹⁷. Other programmes were more extensive, in Austria, Belgium and Czechoslovakia for example (see table 2). Other countries that used this type of currency reform were Poland (1944), Bulgaria (1947), Denmark and Norway. More emphasis will be placed on this type of reform than to the other two types, because it was applied in the Netherlands. Belgium will be used as an example.

table 2-Maximum allotments of new currency in initial exchange

country	amount per person	in dollars
Austria	150 shillings	15.00
Belgium	2000 francs	45.60
Czechoslovakia	500 korunas	10.00
Netherlands	10 guilder	3.75

Source: Lloyd A. Metzler, The Colm-Dodge-Goldsmith Plan Appendix O, page 371

In Belgium extensive conversion preparations had already been made before the end of the German occupation in October 1944. Experiences after World War One led to this swift way of acting. The government-in-exile ordered the printing of new currency in the United Kingdom and the administration in Brussels secretly prepared the organizational part of the currency reform in Belgium. Disagreement existed in Brussels about the type of the reform¹⁸. One group was in

¹⁷ In Finland the banknotes were depreciated to 50% and cut in two. The left side could be exchanged for new currency and the right side was converted into a three year forced loan to the State with an interest of 2%. All banknotes with a value below 500 mark could be exchanged at par value.

¹⁸ See Léon H. Dupriez, page 13-16.

favour of blocking and consolidating all excess liquidity. Next, heavy taxation would be necessary to reimburse the public debt and to injure war profiteers. A second group suggested a decrease in the value of money without creating any public debt. The group called in question that the prolonged and difficult fiscal remedies of a public debt could be brought into correct relation with the monetary reform. Taxes could then be used for other purposes, such as war damage indemnities. The decrease of the value of money would especially hit large liquid asset holders such as war profiteers. The government-in-exile decided in favour of the first alternative; a franc would be exchanged for a franc.

The magnitude of the money contraction was decided upon after the determination of a new exchange rate. Although a definite exchange rate hardly could be calculated because of the turmoil, the Belgian government-in-exile opted for a depreciation of 17% in relation to the British pound sterling¹⁹. Using the theory of purchasing power parities, which compares the purchasing power of the currency in a country with the purchasing power of a second currency in a second country, it was now possible to determine a level of Belgian wages and prices, which kept the country competitive in relation to the United Kingdom²⁰. Taking this wage and price parity, and considering pre-war monetary relations as normal, then a post-war Belgian money supply and purchasing power volume was calculated²¹. Comparing these outcomes with the actual amount in circulation, this means that roughly 50% of the money supply and 45% of the purchasing power had to be blocked, namely

¹⁹ Why this exchange rate? Léon H. Dupriez (page 10): "The obvious answer ... is that this rate had been the rate of the Congolese franc within the Sterling Area since June 1940 and that it therefore appeared as a sort of existing rate for the currency of free Belgium. ... Four years later, the fear of upsetting the price system and the financial assets in the Congo certainly played a part in maintaining the [Congolese] sterling rate for Belgium itself."

²⁰ The new exchange rate of 176.625 to the pound sterling was approximately 1.21 times the old exchange rate of 146 francs during the period 1931-1938. The wage and price level in the United Kingdom multiplied by the 1.21 had the outcome of a $1.45 \times 1.21 - 1.00 = 75\%$ wage increase compared to the pre-war average and a $1.35 \times 1.21 - 1.00 = 63\%$ price increase. The increase in wages permitted relieved the social pressure and grievances, which originated during the war, when wages lagged behind prices and prices on the black market were high.

²¹ With a price and wage parity level of 160 to 170 and an average pre-war circulation of coins, notes, bank and post-check deposits of 49.6 billion francs (a 1936-1938 average) the new money supply would have to be 80 to 85 billion ($49.6 \times 160 = 79.3$; $49.6 \times 170 = 84.2$). September 1944 the money supply was 164 billion francs. The purchasing power, i.e. money supply plus time and saving deposits, was calculated in the same way. September 1944 the purchasing power was 186 billion francs. See also V.A. de Ridder, 1948-1949, page 57, 69, and Léon H. Dupriez, page 6.

from 164 to 79-85 billion francs and from 186 to 101-107 billion francs respectively.

On Friday evening, the 6th of October, Minister of Finance Gutt announced the currency reform. For organizational and safety reasons the government opted for a blockade at home: through the postal service every Belgian household received a form on which it had to report its holdings of all banknotes of 100 francs and higher (96% of the nation's cash)²². The value of the notes not declared between the 9th and the 13th of October accrued to the State. Every Belgian was allowed to convert a maximum of 2000 francs into new banknotes. This exchange operation was carried out in order to provide the Belgians with the liquid assets necessary to secure subsistence until they could live from their current income again. Between the 16th and the 29th of October the notes declared had to be deposited at post offices (only amounts up to 10 000 francs) and banks. The money was then credited on blocked accounts. Three weeks later an additional 3000 francs per person were released. Of the remainder 40% was declared frozen and 60% permanently blocked (see below). In addition, all sight, time and savings deposits at financial institutions, such as banks and the post-check offices, were blocked. However, one important distinction was made compared with the handling of banknotes; the amount of deposits held when the Germans invaded Belgium was not blocked²³. This distinction was to the advantage of higher-income groups. All banknotes and deposits held by the government, public and semi-public bodies, and financial institutions had to be declared only, and then were converted into new assets; the deposits remained completely free. On moral and social grounds later religious and philanthropic institutions also regained the disposal of all their liquid assets.

The monetary reform had several aims²⁴: 1) to stimulate the Belgian economy through the reduction of excess demand (this in relation with the new exchange rate); 2) to support a wage and price stabilization programme; 3) to transform liquid asset holdings into

²² The smaller banknotes did not have to be handed in; these banknotes were issued by another institution, 'le Trésor', and also ensured a minimum of money in circulation. In several countries organizational considerations were influential in the decision not to convert small currency. In Austria such currency became attractive to black marketeers. As a result it disappeared, and low-priced goods had to be increased in price to find buyers. In Belgium the 20 and 50 franc banknotes also disappeared from circulation; they were hoarded in anticipation of a possible new currency reform. From the 28th of October 1946 until the 31st of July 1947 they could be converted into new money. Of the banknotes 90% and 77% were handed in respectively (see Valéry Janssens, *Le Franc belge*, page 325).

²³ Actually, the owner of the account had a choice between taking the entire amount of deposits, existing on the 9th of May 1940, or taking 10% of the total of deposits possessed on the 8th of October 1944. See V.A. de Ridder, 1948-1949, page 59.

²⁴ See Léon H. Dupriez, page 17-18 and Fritz Grotius, page 112-113.

public debt in order to make a recuperation of normal State budgetting possible; 4) to register all taxable assets, especially those of war profiteers; 5) to exclude Germans and collaborators from currency that could be recirculated at a later date; 6) to attack black market prices. During the first period the attack on the black market was fruitless, because this market was the only one where Belgians could buy the goods they wanted²⁵. The Belgian government thought that the aims could be reached through the annulment of the use of the old banknotes, through credit control measures (reserve requirements and consolidation), through gradual deblocking and through taxation.

The credit control measures were taken to prevent an undesirable expansion of the money supply of the banking system, which was in possession of large quantities of rediscountable Treasury bills. The due date, maturing before the 8th of October 1945, was prolonged for one year. The banks had to ask permission of the monetary authorities for all credits exceeding 1.000.000 francs, and interest on private credits was raised several times from 1946 on.

The taxation scheme consisted of three taxes²⁶. A special tax up to 100% on profits from transactions with the enemy. Distinction was made according to the degree of compulsion from German side, and to the origin of the increase of wealth. Without proof non-compulsory transaction with Germans was assumed. A second tax was imposed on excess profits, made between the 1st of January 1940 and the 31st of December 1944. In this tax only the excess share of income and profit were taxed²⁷. Then there was also a capital levy of 5% on all private

²⁵ Saturation of demand by enlarging supply proved to be the best way of combatting the black market. Belgium, in possession of a relative favourable supply of dollars and sterling, could pursue a liberal import policy in contrast with other nations. Nevertheless in Belgium the black market also endured longer than desired by the authorities.

²⁶ To determine the total amount of wealth and the increase in wealth during the war on which the taxation scheme would be based, not only all banknotes and deposits had to be declared, but also all holdings of gold and foreign assets, and all Belgian and foreign securities. All securities had to be deposited at a bank, or otherwise became void and would be attributed to the State. To avoid trade in securities the stock exchange market was closed until June 1945. All life insurance policies, a source of investment of war profiteers, were blocked too, and had to be declared by the companies. Real property was checked through the cadastre. Furniture, jewels, commodities, etc. were excluded from this inventory of wealth.

²⁷ The tax rates on excess income were:
 70% for amounts up to 100.000 francs;
 80% for amounts between 100.000 and 200.000 francs;
 90% for amounts between 200.000 and 1.000.000 francs;
 95% for amounts over 1.000.000 francs (see Léon H. Dupriez, page 34, and V.A. de Ridder, 1948-1949, page 66).

Excess income was calculated in several ways, namely by deducting

capital. The levy was seen as a supplementary tax to raise the yield of the other two taxes, and as a contribution from the Belgians to the reconstruction of the country. For these reasons, exemptions granted were small. Additional to the taxation scheme an amnesty was proclaimed, asking the Belgians to declare truthfully the incomes earned during the war; these declarations would only be subject to a normal tax rate²⁸.

The taxation scheme was designed to neutralize an important part of the excess of demand and public debt. For these reasons 60% of the blocked accounts were permanently blocked; they were fixed at 63.2 billion francs. These accounts would be compensated by the revenue of the three taxes, and the remainder would get the character of a normal public debt. At the end of December 1953 the outturn of the three taxes was 48.1 billion francs which was close to the original estimation of 50 billion²⁹. The other 40% of the blocked account were declared 'frozen'. They were considered as the excess of liquidity during the period of low production. When economic activity progressed, the frozen accounts would be gradually defroze in order to maintain a permanent equilibrium between supply of and demand for money. This release took place through general deblocking measures for the entire economy, for certain economic sectors of the economy, and for certain economic categories of the population (returned prisoners of war, political prisoners, and old people for instance). These measures were issued by the Minister of Finance. The defreeze also took place through specific deblocking for individuals, according to need. This deblocking was executed by a special 'Deblocking Committee' that was fairly generous

from all profits the income and profits normally earned, declared and taxed during the five last tax years before 1940-1944, or by subtracting from gross profits a lump sum of 5000 francs a month, or, in the case of a firm, by deducting 6% of the capital invested. Several other deductions were allowed. But the most important deduction was created through the possibility to reduce taxable profits with an amount equal to the value of the stocks liquidated during the war, multiplied with a factor 1.6 (corresponding with the general price rise during the German occupation). This in order to facilitate the replacement of stocks and to safeguard the real assets of the firms (V.A. de Ridder, 1948-1949, page 65/6).

The percentages of this tax on excess income were higher than in for instance Denmark and the Netherlands. In these countries, however, increase in value of estates was included in the tax (Léon H. Dupriez, page 35).

²⁸ Additional receipts resulting from the fiscal amnesty were estimated at 110 million francs. In reality they amounted to 3.52 billion francs (V.A. de Ridder, 1949-1950, page 33).

²⁹ Nevertheless receipts lagged behind estimates during 1946 and 1947, the first two years the taxes were collected. In 1946 receipts were only 73% of the estimates. This proportion remained the same in 1947, although the estimates had been revised downwards (V.A. de Ridder, 1949-1950, page 33).

to industrial and commercial enterprises until their cash reserves were restored. After that the deblocking on social grounds gradually became more liberal³⁰.

Table 3 shows that soon after the blocking measures the money supply rapidly expanded again. For this several causes can be mentioned. First of all there were the temporary advances to the Allies that reached a maximum of 35 billion francs in December 1945; at the end of 1946 they were mostly payed back (the pay of Allied troops), or compensated in goods and services (Reverse Lend-Lease and Mutual Aid). Until December 1946 about 26 billion francs was added to the money

table 3-The evolution of frozen accounts and money supply (a) (in billions of francs)

	frozen accounts (1)	money supply (2)	increase of (2) (3)	(3) in percentages (4)
Early Sept. 1944	0	164.285 (b)		
Oct. 1944	39.1 (c)	57.400 (d)	-106.885	
Dec. 31, 1944	37.0 (c)	74.256	16.856	
Dec. 31, 1945	22.5	131.522	57.266	77.1
Dec. 31, 1946	14.0	145.567	14.045	10.7
Dec. 31, 1947	10.0	151.217	5.650	3.9
Dec. 31, 1948	2.6	162.239	11.022	7.3
Dec. 31, 1949	0	166.802	4.563	2.8
Dec. 31, 1950		171.910 (156.100)(e)		
Dec. 31, 1951		(168.547)	12.447	8.0
Dec. 31, 1952		(174.541)	5.994	3.6

Source: Valery Janssens, *Le Franc belge*, page 320 (column 1), page 433/4 (column 2)

- (a) Bank notes, current accounts of the National Bank, bank accounts to 30 days and private checking accounts.
 (b) Léon H. Dupriez, page 6.
 (c) V.A. de Ridder, 1949-1950, page 28.
 (d) Léon H. Dupriez, page 22.
 (e) Changed calculation: without the money in the cash of the monetary institutions.

supply by the defreeze of accounts. Furthermore between December 1944 and December 1946 commercial credits with a value of 10 billion francs were granted by the National Bank and private banks. The most important factor, however, was the deficit in the State budget. The direct

³⁰ V.A. de Ridder, page 62. The total amount of deblocking by the committee was 7.2 billion francs (see Valery Janssens, page 320).

central bank advances to the government increased from approximately 17 billion francs in October 1944, an estimation because of lack of official figures, to 47.1 billion at the end of 1946. During the same period the amount of free post-check deposits, used for current financing, increased from 6.7 billion francs at the end of 1944 to 21.1 billion at the end of 1946. Of a total deficit of 72.9 billion francs in 1945 and 1946 combined, only 12 billion could be covered by long-term loans. Also 6.5 billion francs was borrowed from Canada and the United States³¹.

All in all this made the money supply increase to 145.6 billion francs in December 1946, or 89% of the amount just before the currency reform of 9 October 1944, while 14 billion francs was still left in frozen accounts! At that time, production was only at the pre-war level. The economy of Belgium in December 1946 therefore was still threatened by inflation. In 1948 the growth of the money supply accelerated again, because of the deblocking of most of the frozen accounts (see table 3). The Korea-boom also caused a temporary acceleration. The aftermath of the currency reform lasted until the end of 1971 when the last financial obligations were paid off³².

The third type of currency reform combined the deflated exchange rates with a freeze in blocked bank accounts of the remaining supply of currency and deposits. The reform applied by the three western Allies in West Germany is a perfect example of this combination of monetary measures.

By the middle of 1948 the German economy was almost paralyzed. Cigarettes, coffee and tea had become the most appreciated units of account and means of payment. Especially cigarettes were inflationproof and had a stable exchange rate. Increased supply did not matter because when cigarettes had functioned as means of payment they often disappeared from circulation, in a manner of speaking they disappeared into thin air. Money had almost ceased to have a function. As store of wealth manufacturers, businessmen and storekeepers had hoarded all kinds of goods. The displays of the shops were empty; nobody wished to be paid in currency and everybody waited for the long-expected currency reform that was delayed by disputes of the four Allies about this subject.

In secret new Deutschmarks (DM) had been printed in the United States and transported throughout West Germany. From June the 20th to June the 27th 1948 all Reichsmarks had to be handed in. From the 21st onward only Deutschmarks could be used as currency. Of the money that was handed in each person regained 40 DM, the rest was put on bank accounts that were all depreciated to 10%. Between the 20th of August and the 11th of September another 20 DM per person could be obtained, of course under the condition that at least 60 Reichsmarks were handed in in June. Only those who had no bank account were allowed to receive the deutschmarks at an exchange rate of 1:1, the so-called 'Kopfgeld'. The others had to pay more for the 60 DM, because all earlier deposits

³¹ V.A. de Ridder, 1948-1949, page 30-31.

³² Valery Janssens, page 322.

were depreciated to 10% too. The same depreciation was applied to all debts, including the debt of the Reich, mortgages, bank loans, and insurance policies. Firms and other employers were entitled to 60 DM per employee in order to meet the first week's payment. Of the bank accounts that were accumulated 50% would be released after approval of the tax authorities³³. On the 4th of October the other half of the balances was depreciated to 30%, one third to be used for investment in medium and long-term securities. Thereby the value of the money on the bank accounts was decreased to 6.5%. In this depreciation private claims were excluded. This policy was determined by the three western Allies. The then already residing German administration removed the price and quantity controls. Rationing only remained for basic foodstuffs, rents, transportation, coal, iron and steel. A few months later also wage controls were abolished.

The effects of the currency reform were startling. On the first day of the reform the shops were filled with goods again. This supply was the main reason for acceptance of money as measure of value by the population. Also absenteeism at work decreased from 9.5 hours a week in May to 4.2 hours in October³⁴; money had become more desirable as means of exchange.

Still there was criticism on the implementation of the currency reform; not all property had been treated equally:³⁵

"... the owners of real assets were favoured compared with the holders of private claims in the form of loans or securities², and the latter were in turn favoured as compared with the owners of bank deposits, which were reduced in a larger portion than private claims; among the owners of liquid funds those were favoured who had little cash, since they obtained the "Kopfgeld" at the ratio of 1:1, whereas those with sufficient cash (including RM [Reichsmark] bank balances) lost at the ratio of 16:1."

In July 1948 79% of the West Germans thought that certain strata of the population had gained advantages through the currency reform, particularly businessmen, manufacturers, and capitalists. Also the

³³ This release was completed in January 1949.

³⁴ F.A. Lutz, page 133.

³⁵ F.A. Lutz, page 127. In his note 2 he remarks: "The owners of real estate have had their mortgage reduced in the ratio of 10:1; they continue, however, to pay interest on the full original amount of the mortgage, and nine-tenths of their payment goes to the land in which the property is situated."

destruction of savings and its consequences for savings morale were point of criticism.

Social injustice was not unforeseen, however. As part of the first American currency plan in 1946 an equalisation of the war burden ('Lastenausgleich') was built in. The Germans had already experienced one in 1924 after the currency reform of 1923/4. Yet at the last minute the Americans insisted on separating the monetary reform and the Lastenausgleich³⁶. The Lastenausgleich was designed as a mortgage of 50% on the value of all real property and equity holdings. A fund was set up to accumulate repayment and interest payments. From this fund people would be paid who had suffered during the war, and who were victimized by the currency reform. Until 1974 the outlays of the fund were DM 94 billion, nearly as much as its inlays were³⁷. But those Germans whose savings had vanished by the currency conversion were only compensated with two Deutschmarks for each ten Reichsmarks³⁸. The rest of the expenditure of the fund went to expelled Germans, to victims of the war, and to compensations for lost property in the east of the German Reich³⁹.

In two countries, Rumania (August 1947) and East Germany (June 1948), a quite similar currency reform was put into effect. However, these countries took redistributive measures concerning economic class and saving deposits respectively⁴⁰. The reform in the Soviet zone of Germany was applied nearly at the same time as in the three other zones, and was a reaction on the currency measures in the latter areas. The Soviets therefore could not introduce a new currency immediately; they slightly changed the old banknotes.

³⁶ Charles P. Kindleberger, in 'A Financial History of Western Europe', on page 418 claims that one person, Kenneth Royall, in nominal charge of the occupation forces, could prevent the Lastenausgleich with his ideological objection to capital levy as contrary to the American way of life.

³⁷ Hans Möller, Die Westdeutsche Währungsreform von 1948, page 478.

³⁸ Only savings, securities and life insurances kept from the first of January 1940 on, were compensated in this way.

³⁹ Hans Möller, page 478.

⁴⁰ In Rumania farmers were allowed to exchange 5 million lei per family and all the others 1.5 million lei per person (see F. Grotius, page 318). The currency reform in West Germany did not make distinction between economic classes but was disadvantageous for large money holders as for instance farmers.

4. Reconstruction policies: a discussion about the expansionist economic policies of the Western European countries in 1945-1947

One of the economic features after World War Two was the increased importance of the dollar area in international trade. This resulted in a huge Western European trade deficit with the United States that would leave its mark upon the postwar period. In the 1930s these deficits had been financed by invisible earnings in dollars (shipping earnings, investment income, and tourist earnings in particular), and by export surpluses with other, so-called third areas in the world. The war and disinvestment in order to finance the primary reconstruction effort after the war had decreased the invisible earnings⁴¹. A changing pattern of trade because of the war had diminished the possibilities of financing the dollar deficits through trade with third areas; these countries had increased trade with the United States themselves during the war, and during their own recovery after the war. The absence of food imports from Eastern Europe further reinforced the changing pattern in favour of the dollar area. The disappearance of Germany from the international markets also had this influence, mainly in coal, iron and capital goods. A serious dollar shortage developed, because Europe could not finance the increased dependence on particularly the United States; exports to the United States could not match the imports from this nation, and financing through disinvestment and monetary reserves could not be prolonged for long⁴². Two years after the war had ended serious payment problems arose (see table 4). The bad winter of 1946/7 and a poor harvest in 1947 aggravated this because of shortages in coal and food.

⁴¹ The members of the CEEC (Committee of European Economic Cooperation, see not 50 for the members), later OEEC (Organization for European Economic Cooperation) in 1938 had a surplus on invisibles of approximately \$ 2000 million (OEEC-figures). The balance of the invisibles on the current account in 1947 is recorded to be a \$ 750 million deficit. Figures of the IMF (International Monetary Fund), however, suggest an equilibrium in 1947. The deterioration of the invisible earnings was approximately a quarter or a third of the overall deterioration of the balance of payments between 1938 and 1947 (see Alan Milward (1984), page 42).

⁴² In 1947 Western Europe lost about \$ 2500 million in gold and dollar holdings, about a third of its total holdings at the beginning of the year. During 1947 the gold and dollar holdings of the United Kingdom, which were also those of the sterling area, decreased to approximately half the size of the total gold and dollar drain of that year. The gold and dollar holdings of France and the Netherlands decreased to approximately one-third, and those of Italy to approximately one-tenth. In Denmark foreign exchange reserves even dropped below normal working balances.

table 4-Deficits on merchandise trade of OEEC countries with the United States (million current dollars)

country	1946	1947
Austria	(+) 0.56	(+) 0.38
Belgium/Luxembourg	192.07	457.38
Denmark	42.38	104.96
France	649.13	956.19
Italy	112.19	350.06
Netherlands	187.13	431.13
Norway	82.28	173.43
United Kingdom	764.07	950.08

source: Alan S. Milward, 1984, page 26.

What were the reasons of the deterioration of the balance of payments? Alan Milward rejects the commonly accepted view that food and coal shortages in Western Europe were of importance. He also disagrees with the opinion that there was a general economic stagnation in Western Europe with deteriorating social conditions, an opinion that was common among United States' policy makers and that is the conventional view⁴³. In his opinion it was not the stagnation of recovery, but the increased level of investment in machinery, steel, and vehicles that caused the growing dollar shortage of Western

⁴³ Undersecretary Clayton of the United States government who played an important role in stimulating the Marshall Plan, had visited Europe. In his view Europe was in grave distress, leading to a breakdown of market connections between city and countryside. The United States policy makers were afraid of the consequences they expected from a Western European economic collapse. They were worried about the growing communist influence and gave special financial assistance to France and Italy in the winter of 1946/7, as president Truman stated, to help both countries "survive this critical winter as free and independent nations" (Harry B. Price, *The Marshall Plan and Its Meaning*, page 47). See John Gimbel, chapter one, for a synopsis of the different views on the motives of the United States policy makers.

Although Milward acknowledges that agricultural production in Western Europe was well below its average level of the period 1934-1938, he is not convinced of a decreasing standard of living in 1947 (page 13). According to him caloric intake per person increased, and also infant mortality rates improved to at least pre-war level in almost every country. Even the standard of living (i.e. the movement of money wages plotted against the movement of the cost of living index, or of the retail prices) did not decrease in 1947 as compared to 1946, except in Italy, France and Belgium.

Europe⁴⁴. In other words, instead of a stagnation it was on the contrary the success of recovery that caused the trade deficits. Milward finds it amazing that government policies of low interest rates, trade controls, and public funds aimed at stimulating investment, remained so stubborn when the available European sources of finance for imports had dried up⁴⁵. He considers European economic policies as overambitious and too expansionistic, and even compares the Western European countries with lemmings that more or less deliberately followed a fatalistic direction, under the assumption that the United States would eventually have to act. The European Recovery Program (ERP) or Marshall Plan, in his view, justified this assumption⁴⁶, and enabled the countries to continue their expansionistic policies. Milward was not the only one with this opinion; already in the 1940s a group of economists considered Western Europe to live beyond its means⁴⁷. In their view the high spending of the governments and the corresponding inflation policies encouraged imports, increased domestic demand at the expense of exports and therefore delayed the attainment of a external equilibrium. They stated that the balance of payments problem could be solved in the short term, provided that inflation would be stopped, and overvalued exchange rates adjusted. Exchange controls could be loosened then, and quotas for goods eliminated.

Seymour E. Harris, among others in the 1940s, thought that this view was oversimplifying the situation when heavy disinvestments during

⁴⁴ Alan S. Milward, *The Reconstruction of Western Europe 1945-51*, 1984, page 36.

⁴⁵ Especially investment in transport and communication was high, for instance ship building received priority (Alan S. Milward, page 38). The advantage of having ships again was that the high costs of using American ships would be avoided. But most of the steel had to be imported from the United States because of a low permitted output of the German steel industry. This also had its effects on the dollar balances. By the end of 1949 the priority given to shipbuilding in most Western European countries resulted in larger fleets than before the war.

⁴⁶ Alan S. Milward, page 49-51. He especially mentions France and the United Kingdom.

⁴⁷ See for instance Gottfried Haberler in *The American Economic Review* of September 1948, page 509. Others who shared this opinion were Graham, Machlup, Lutz, Viner, Harrod and Hazlitt. According to them and Milward the Marshall Plan was not needed, with the notable exception made by Milward for France and the Netherlands.

the war were considered⁴⁸. He also did not agree with the opinion that devaluation of overvalued currencies was of first-rate importance, because exports could not be increased sufficiently due to scarce production facilities. In his opinion it was the allocation of resources that was of the utmost importance to yield the largest supply of dollars. According to Harris circumstances with regard to growing industrialization, real costs, demand, and the effects of post-war patterns of trade restriction were too uncertain to determine suitable exchange rates in 1947. He considered price increases in the United States as decisive for the dollar gap, something Milward does not mention. In 1946 in the United States the Price Control Bill was not renewed, this increased prices considerably⁴⁹, and, according to Harris, thereby worsened the European dollar position:⁵⁰

"Of Europe's total adverse balance of \$ 7.5 billion in 1947 the rise in trade deficit (in 1938 dollars) accounted for about a sixth, the rise of international prices for almost one-half, and the losses on invisibles accounted for little more than one-third."

On the trade balance about three quarters of the growing deficit during the period 1938-1947 can be explained by the increase in the prices of international commodities⁵¹ (see table 5). Comparing 1946 to 1947 increased prices accounted for 86% of the growing trade deficit.

⁴⁸ Seymour E. Harris, *The European Recovery Program*, page 41.

⁴⁹ Using 1938-1939 as a standard, the index of American wholesale prices between June 1946 and February 1948 increased from 147 to 210, retail prices increased from 150 to 192 (see Van der Wee, *De gebroken welvaartscirkel*, page 16).

⁵⁰ Seymour E. Harris, page 51. With Europe Harris meant the sixteen ERP countries and West Germany; Eastern Europe was excluded. The sixteen ERP countries were Austria, Belgium, Denmark, France, Greece, Iceland, Ireland, Italy, Luxembourg, the Netherlands, Norway, Portugal, Sweden, Switzerland, Turkey and the United Kingdom.

⁵¹ The difference in the deficit between 1938 and 1947 (in 1938 prices) is approximately 1.200, using current prices this difference is 4.800. This makes prices to cause a three quarter difference of 3.600 (see table 5).

On the current account of the trade balance this was 91%⁵². Interpreting figures in this way, however, can be misleading. Because when we consider price indices, comparing 1938 and 1947, the prices of exports and imports both increased to 210%. What really was the problem of Europe, was the fact that imports far exceeded exports. As a result, a price change of imports equal to, or even less than a price change of exports would enlarge the trade deficit (low elasticity). Thus, extra price increases in the United States during 1947 worsened the European dollar position, although in 1947 the terms of trade were probably above the 1938-level⁵³.

table 5-Europe's trade with non-European countries (millions of dollars)

	1938		1946		1947	
	current prices	current prices	1938 prices	current prices	1938 prices	
Imports, f.o.b.(a)	5.820	9.400	5.350	13.000	6.200	
Exports, f.o.b.(a)	3.730	4.300	2.300	6.100	2.900	
Trade deficit	-2.090	-5.100	-3.050	-6.900	-3.300	

source: Seymour E. Harris, page 50

(a) Free on board

Using other sources Robert Triffin thought price changes to have had a 20% influence on the growing trade deficit between 1938 and 1947, and volume changes to have had a 80% influence. He nevertheless also mentioned price movements as a major cause of the 1947 deficit⁵⁴. What is of importance here is that the Western European trade deficit could not be reduced as easily as Alan Milward and Haberler c.s. suggested. In fact, this reduction was not desirable. I will comment on this further.

⁵² Giorgio Fodor, Why Did Europe Need The Marshall Plan, page 20. Fodor uses the same figures as Harris.

⁵³ Robert Triffin, Europe and the Money Muddle, pages 32 and 315. Terms of trade are defined as the ratio of the average value indices of exports and imports. Average value indices are calculated by dividing value indices by volume indices.

⁵⁴ Robert Triffin, pages 32 and 313. Volume changes were the result of low exports (in 1938 prices) compared to 1938, whereas imports in 1947 (in 1938 prices) were approximately at the 1938-level.

The balance of payments problems in the late 1940s look a lot like the problems many developing countries experience in the late 1970s and in the 1980s: problems concerning production and sale, and a big need for imports. And most important of all, a need for foreign capital goods. Then a deficit on the current account of the balance of payment is necessary, as was the case in the United States in the nineteenth century and in Europe after World War Two. As the developing countries do now, several development paths were taken in Europe. In the Netherlands, the United Kingdom, Germany and the Scandinavian countries the economy was regulated with wage, price, export and import controls and sometimes with rationing. In the United Kingdom this policy was continued for a long time; the last rations disappeared in 1954. Other countries did not eliminate market forces as much. Belgium promoted economic recovery by liberating most constraints on consumption, those on foreign exchange included. In Italy and France effective price and distribution controls were absent, wages followed the high increase in prices and the currencies depreciated continuously. The social effects of inflation on wealth and income were generally allowed to work themselves out in both countries. All Western European nations tried to increase capital formation as much as possible. As is the case with many developing countries nowadays, this expansionary policy was criticized as being overexpansionary because of balance of payments problems. Monetary reserves declined because of the deficits and for this reason the continuance of this policy could not last long. All countries chose not to deflate, Italy excepted.

In the Netherlands the dilemma of the choice between further limiting imports and deflation policies was shown by the Minister of Finance Liefstinck who declared imports difficult to reduce. On the other hand, according to him, a reduction of consumption would decrease productivity and stimulate black market trade, and a reduction of investment would hamper production and export⁵⁵. Late December 1947 the government of the Netherlands in spite of fastly decreasing monetary reserves decided to wait for the American aid that was expected. Nevertheless, cuts on imports of especially dollar goods had already been enacted a few months before. Other countries changed their policy more clearly: in Austria a third currency reform was introduced in November/December 1947, in France a program of tax increase and a second currency reform were executed, and Italy announced a severe anti-inflationary program, the United Kingdom reached a budget surplus for the fiscal year 1948, and in Belgium import controls for dollar goods were reinstated in September 1947. So Western European countries did act and could not really be called 'lemmings', as Alan Milward did. To most Western European countries in 1947 the alternative of further deflation, and for some the balancing of the budget, was not acceptable in a situation in which exports contrary to imports were far below pre-war level, and in which social welfare was still low.

⁵⁵ Pierre van der Eng, *De Marshall-hulp een perspectief voor Nederland 1947-1953*, page 45.

5. The restrengthening of market forces

After the 1947-'crisis' a next important moment in reconstruction was formed by the wave of devaluations in 1949. A policy measure classically oriented economists had wished to happen in 1947/48, but that had been rejected by others as premature.

The revival of the foreign exchange system was started in the last phase of the war. New exchange rates had to be determined to facilitate financial transactions between countries. Conditions, however, were not favorable, particularly not where governments were in exile. They had to rely on information via underground sources in the calculation of what might be the effect of enemy withdrawal. The effects of the war were hard to estimate, consequently the exchange rates had to be considered as provisional. An important consideration was that the exchange rate ought to contribute to reconstruction, and especially to favorable effects on inflation. This resulted in overvalued currencies in relation to the dollar and to a lesser degree to the pound sterling in 1944⁵⁶, which were safeguarded by foreign exchange controls. First and foremost internal recovery and stabilization had to be achieved again, before exchange rates would play their role in the economy once more.

In the late 1940s increasing production, and a more stabilized money supply decreased the threat of inflation in several Western European countries, except in Austria, France, Greece and Italy. Recovery was not fully reached in the late forties, but relaxation of controls was started. In the Netherlands for instance the government decided to liberate price controls and rationing gradually. More and more market forces were allowed to influence national economies again. In the case of the Netherlands import prices could affect interior prices more now. Therefore ultimately the overvalued exchange rate would have to be adjusted in order to remain competitive on the world market.

The devaluation of the pound sterling in September 1949 was the start of a whole series of currency adjustments. The United Kingdom, like other Western European countries, still had a gold and dollar deficit with hard-currency nations. An export surplus to other countries, on the other hand, yielded a surplus of inconvertible currencies such as the Dutch guilder and the French franc. Therefore there were balance of payments problems in the United Kingdom, although the current account was nearly in balance in 1948 and 1949. A combination of events was the cause of the devaluation that eventually took place four years after the war⁵⁷. There was an increase in British imports from the United States during the second quarter of 1949, which was followed by a deliberate cut in imports during the following

⁵⁶ Frank A. Southard, *The Finances of European Liberation*, with special Reference to Italy, page 142.

⁵⁷ See also Alec Cairncross, *Years of Recovery*. British Economic Policy 1945-51, chapter 7.

quarter by the United Kingdom, and by the Commonwealth as well. Since the monetary reserves of the United Kingdom were also those of the Commonwealth, the behaviour of this group of countries was important, especially when the reserves were not high, as was the case in 1949. In addition to this the United States fell into a mild depression, and bought less primary products from Commonwealth nations like Malaya and Australia; a further drain of monetary reserves was the result⁵⁸. Furthermore there was some pressure from the United States and Canada to adjust the exchange rate of the pound sterling. This strengthened market opinion, and expectations of devaluation arose, which encouraged all kinds of anticipation such as the discouragement of the holding of sterling, deterrence of purchases payable in sterling, a flight of capital, and probably a delay in British exports to the dollar area. This market behaviour was a decisive factor in the British decision to devalue⁵⁹.

The decrease of the exchange rate to \$2.80 per pound was chosen in order to avoid a second devaluation⁶⁰. The measure was accompanied with a moderate program of cuts in State spending, and by an agreement with the trade unions to continue the standstill in wages as long as prices did not increase more than five percent. The British devaluation was followed by many countries in Western Europe (see table 6), partly because of the same reasons, but mainly in order to restore the competitive relations.

The effects of the devaluation on trade are hard to measure. Other economic developments impede this, namely the increase of coal, steel and grain production in Western Europe, and the rapid acceleration of Western European exports to the United States in 1950 when economic activity in the United States recovered and hostilities in Korea started. One important effect may have been that the increase in prices of dollar goods reduced the demand for these goods to below the level of actual imports during the period before the devaluation, thereby releasing dollars for the import of other commodities, and decreasing

⁵⁸ The gold and dollar reserves fell from £471 million at the end of March to £330 million on 18 September.

⁵⁹ A. Cairncross (page 206): "It is significant, for example that, although the trade deficit of the sterling area with the United States fell by \$100 million in the third quarter, the loss of reserves up to 18 September was higher than in the second quarter, and in the last 30 days before devaluation amounted to £42 million (compared with £65 million in the whole of the second quarter)."

⁶⁰ "When the Chancellor came to expound the decision to the House of Commons on 27 September he laid stress on two factors. First there was the need to put British exporters to North American markets in 'a fairly competitive position'; this seemed to call for a rate as low as \$ 3 especially as some cheap sterling transactions were taking place below this rate. There was, second, a need for finality: the rate had to be low enough to remove any danger of a second devaluation." (Alec Cairncross, page 187).

the pressure on the control authorities. Anyhow, in 1950 and the following years price controls and rationing were dismantled in countries where they still existed. A clear effect after the devaluations was the reversal of the capital movements towards Western Europe.

table 6-The extent of European currency devaluations relative to the dollar (in %)

United Kingdom	30.5
Denmark	30.5
Norway	30.5
Netherlands	30.2
France	21.8
West Germany	20.6
Belgium/Luxembourg	13.0
Italy	8.0

source: Alan S. Milward, page 293.

Since the Korea-boom the payments surplus of the United States decreased sharply, while countries in Western Europe experienced balance of payments surpluses. As a consequence the so-called dollar shortage disappeared, which was a clear signal of continued recovery. The payment surpluses coincided with a rapid relaxation of import and exchange restrictions.

Prices were remarkably stable in most countries, though the overliquidity of the banking system was still present. During the war the Western European nations had financed their budget deficits on the money and capital markets. The banks on the Continent largely financed these deficits, and bought many Treasury bills that could be converted into money in a short term. After the war this situation contained the imminent danger that the lending to the government would not be continued at the due date of the Treasury bills, and that instead, the lending to the private sector would be enlarged in an uncontrollable way. In Italy this actually happened. In Belgium in 1946 was decreed that in the larger banks 65% of the short-term assets would have to be in the form of cash and Treasury certificates⁶¹. Nevertheless, an important part of the private sector did not have to borrow from the banks; in several countries they could not buy as much as they wished as a consequence of the demand control systems. The liquidity of the

⁶¹ Léon H. Dupriez, page 72. In this way the market of Treasury certificates expanded when the bank deposits expanded. The banks had to rediscount at the Banque Nationale when they wished to expand their credit in a situation in which they had reached the ceiling of 65%. Then an increased discount rate would become effective. Dupriez added that somewhat lower figures were set for smaller banks.

private sector stimulated low interest rates and favoured governments who were the only large borrowers⁶². The so-called cheap money made borrowing attractive, but was a psychological hindrance for the consolidation of the short-term government debt into longer terms; only those amounts were consolidated that would not influence the interest rates. So when the 1950s came a large part of the consolidation still had to take place in some countries. In 1951 this happened in the United Kingdom (and in the United States) and in 1952 and 1954 in the Netherlands.

The beginning of the 1950s also meant a start of monetary policy by the central banks. For the first time since the war these monetary authorities increased the discount rate in Western Germany, the Netherlands and the United Kingdom. In Italy this had already happened in 1947 as a part of the deflation policy with its credit restrictions, and in September 1948 in France along with quantitative measures as the institution of reserve requirements for the banks and a limit for rediscounting at the Banque de France. In Belgium the government did not regulate long term interest rates, with the consequence that money in Belgium was 'more expensive'. The consolidation of government debt in the other countries, and consequently the decreased liquidity of the banks, after a while made the interest policy of central banks more effective again as an instrument to control credits to the private sector. The reinstatement of the role of the central banks is another signal of restoration of pre-war economic relations.

Trade relations in Western Europe became more normal as well. In 1950 the European Payment Union was founded with starting capital from the Marshall plan. The European Payment Union was a multilateral clearing institute that facilitated trade in Western Europe, and removed the disadvantages of bilateral trade agreements⁶³. By 1952 the

⁶² The discount rate in Norway, the Netherlands, and the United Kingdom was 1.5 to 4%. In Western Germany it was kept at 5% all the time, but after June 1948 it reached a maximum of 6% in 1950; before that, other credit restrictions had decreased the liquidity of the banks. In Italy it was raised from 4 to 5.5% in 1947 as a part of the deflation policy. In France a cheap money policy was pursued in a more active way. Warren C. Baum, *The French Economy and the State*, page 61: "... the government sought ambivalently to facilitate the use of credit for the recovery of business activity while attempting to discourage its use for "inflationary" purposes." In January 1945 the Banque de France had reduced the discount rate to 1.625%.

⁶³ Before, the CEEC countries had set up a common fund in October 1948. In this fund 'soft' currencies were made available; net-creditors to the fund would get 'hard' Marshall dollars instead. The arrangement, however, was still based on bilateral relations, because automatic clearing was applied before drawing rights could be executed. After a year 25% of the drawing rights from the fund were made multilateral; June 1950 this was 100%. From October 1950 on the European Payment Union organized this multilateral payment scheme (see Pierre van der Eng, page 71/2).

extreme pressures of the immediate post-war period had almost disappeared. Some restrictions on prices, wages and trade still existed. Restoration of full convertibility, which would be an important step to full liberalization of the trade in goods and services, had to wait until 1958.

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