

# ***Reconstruction after Two World Wars - Why the Differences?***

**Andrea Boltho\***

Magdalen College, University of Oxford

## **Introduction**

Western Europe's position in 1945 looked dramatic. Devastation during the war had been unprecedented, millions of people had been displaced, many economies were hopelessly dislocated. Shortages of food and raw materials were widespread and much of the shipping needed to bring supplies in from overseas had been sunk. Few parallels can be drawn with the situation in 1918. Destruction at the time had been limited to parts of France, Belgium and Italy, and there was little of the chaos and penury of 1945. It is true that, at home, both periods witnessed initial domestic challenges to the established order, but these were subsequently reabsorbed. And at the international level, a Peace Treaty had been signed on the earlier occasion while on the more recent one cold war tensions were beginning to surface between the two major erstwhile allies (the United States and the Soviet Union).

**TABLE 1. GDP growth (average annual trend growth rates)**

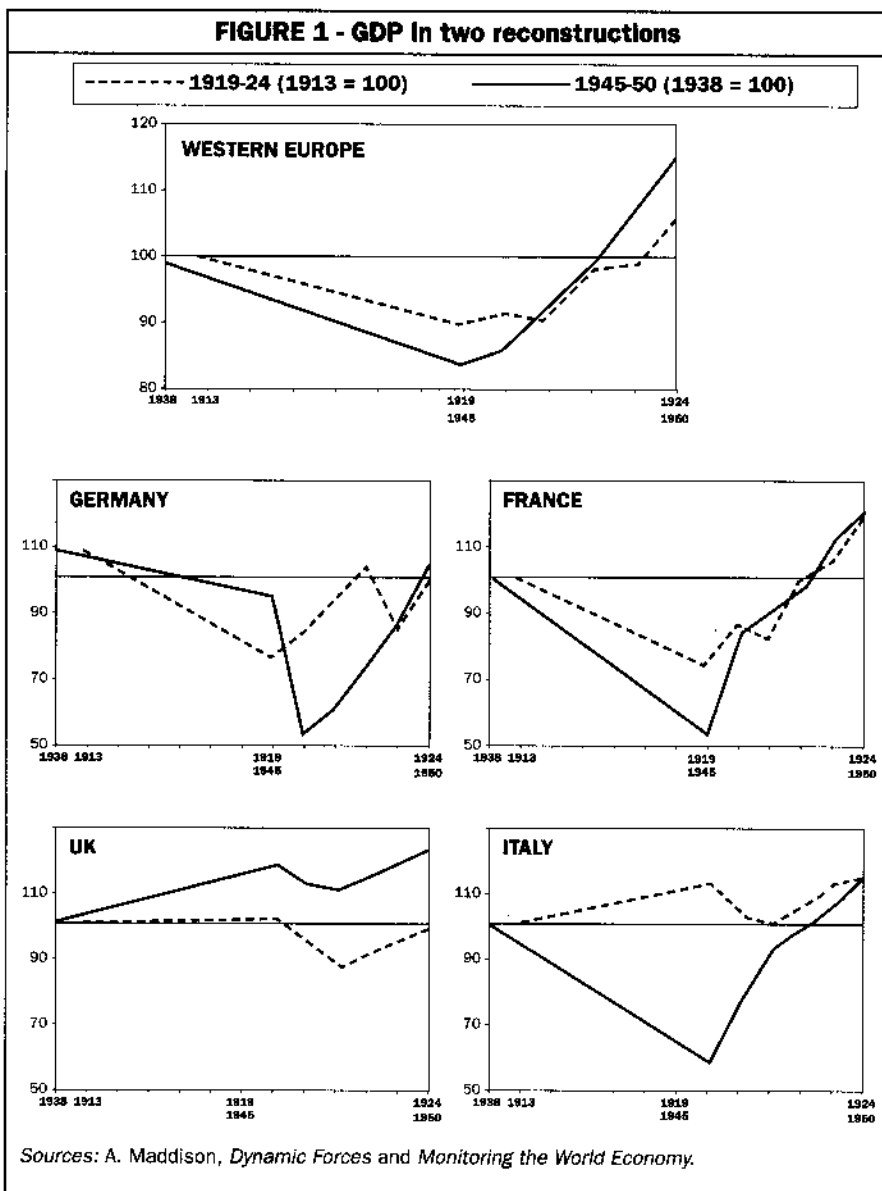
	<b>Europe*</b>	<b>France</b>	<b>Germany</b>	<b>Italy</b>	<b>UK</b>
1919-24	3.5	8.2	3.8	1.1	-0.2
1946-50	7.8	9.0	15.5	8.6	2.4

\* 12 countries: France, Germany, Italy, U.K., Austria, Belgium, Denmark, Finland, Netherlands, Norway, Sweden and Switzerland.

Sources: A. Maddison, *Dynamic Forces and Monitoring the World Economy*.

\* Many improvements to an earlier version were suggested by Andrew Glyn and Chris Allsopp, who bear no responsibility for any errors and omissions.

In many ways, the Europe of 1918 could get down to business as if little had changed, while the Europe of 1945 was in the throes of a major crisis. The former was able to look back to a long period of prosperity and forward to peace. The latter's past had been the depression and the protectionism of



the 1930s, while its future ominously threatened a renewed world war. While in 1919 in Britain "the rich [could plan] to spend more and save less, the poor to spend more and work less",<sup>1</sup> and Italy could look forward to "paradise on Earth",<sup>2</sup> few, if any, expressed such hopes in 1945.

Yet, and despite these very different starting points, the economic (as well as the political) reconstruction after 1945 turned out to be much more successful than the reconstruction that followed 1918. Not only did output and trade grow significantly faster in the later 1940s than they had done in the early 1920s, but the basis was also laid for future international economic cooperation, in contrast to the divisions and failures of international management which marked the post-1918 years. This legacy turned out to be very significant. Post-World War II reconstruction ushered in the "Golden Age" of the 1950s and 1960s. Post-World War I reconstruction was followed by the disastrous decade of the 1930s.

The paper investigates some of the reasons for these marked differences. Section I looks at the outcome in terms of output and factor inputs. Sections II and III then consider less quantifiable influences, examining, in turn, the role of domestic and international economic policies. A brief summary is provided in the Conclusions.

## **I. Growth and factor inputs**

As just stated, performance in the two periods was very different.<sup>3</sup>

<sup>1</sup> Keynes, *Economic Consequences*, p.2.

<sup>2</sup> Einaudi, *La condotta economica*, p.242.

<sup>3</sup> Definitions of when the two periods start and end are, inevitably, somewhat arbitrary. It has been customary to take as a reference point the last pre-war years in which peacetime conditions prevailed: 1913 and 1938. The latter may not be strictly comparable to 1913 because capacity utilization was relatively depressed in a number of European countries at the time, but it is still better than any alternative year in the 1930s. Somewhat more difficult is the choice of starting and terminal years after the wars. 1919 and 1946 look reasonable as initial years since both 1918 and 1945 were still distinguished by military conflict and major dislocation. 1924 could be taken as a convenient end-point for the first episode because in that year output in Europe went above the 1913 level. To preserve comparability one could either choose 1948 (when output reached the 1938 level) or 1951 (five years after the starting point). 1950 is chosen as a compromise. In practice, the GDP trend growth rates over these various periods are almost identical (7.7 per cent per annum for 1946-49, 7.8 per cent for 1946-50, and 7.5 per cent for 1946-51).

Trend output growth between 1946 and 1950 for Western Europe as a whole,<sup>4</sup> at over 7½ per cent per annum, was more than twice as rapid as the 3½ per cent recorded from 1919 to 1924 (Table 1 and Figure 1). The improvement is similarly marked for unemployment which increased sharply between 1913 and 1924, but declined between 1938 and 1950 (to a level below that of 1924), despite the large rise in the number of jobless in a West Germany submerged by refugees (Table 2). The price picture is much less flattering, with average inflation in the post-World War II years, at over 20 per cent per annum, significantly above the 3 per cent average of the 1919-24 period, but the latter figure omits the hyper-

**TABLE 2. Unemployment and Inflation**

	Europe	France	Germany	Italy	UK
<i>Unemployment<sup>a</sup></i>					
1913	1.8 <sup>b</sup>	1.2	1.9	1.7	2.1
1924	4.5 <sup>b</sup>	1.2 <sup>b</sup>	5.8	..	7.1
1938	5.7 <sup>c</sup>	3.7	1.3	4.6	9.2
1950	4.2 <sup>c</sup>	2.3	8.2	6.9	2.5
<i>Inflation<sup>d</sup></i>					
1919-24	3.2 <sup>e</sup>	8.1	..	7.8	-4.3
1946-50	21.4 <sup>f</sup>	31.8	5.5	17.6	4.6

<sup>a</sup> In per cent of the labour force.  
<sup>b</sup> 8 countries: France, Germany, U.K., Belgium, Denmark, Netherlands, Norway and Sweden.  
<sup>c</sup> 1926.  
<sup>d</sup> 12 countries (see fn.a to Table 1).  
<sup>e</sup> Average annual percentage changes.  
<sup>f</sup> 10 countries: France, Italy, U.K., Belgium, Denmark, Finland, Netherlands, Norway, Sweden and Switzerland.

Sources: A. Maddison, "Economic Growth in Western Europe, 1870-1957", *Banca Nazionale del Lavoro Quarterly Review*, March 1959, *Economic Growth in the West* (London 1964), *Phases of Capitalist Development* (Oxford, 1982) and *Dynamic Forces*.

<sup>4</sup> All Western European totals have been obtained by adding available country data (the exact country coverage varies depending on the series considered and is shown in footnotes to the various tables), with GDP weights taken from Maddison, *Dynamic Forces*, p.198 (average of 1913 and 1929 for the period following World War I, and average of 1938 and 1950 for the period following World War II). These weights underestimate the importance of Germany in the years 1919-24 since Maddison's data apply to the territory of the post-World War II West German state. Allowance for a larger German weight (based on estimates shown in Maddison, *Monitoring the World Economy*, would, however, not make much difference to any of the conclusions here reached).

inflation experiences of Germany and Austria. A rough allowance for those two episodes would push annual inflation in Europe as a whole over the post-World War I years close to (a not very meaningful) 10,000 per cent. Finally, Europe's exports, which in 1924 were still one quarter below their volume of 1913, had, by 1950, outstripped their (admittedly depressed) 1938 level by as much as one third.<sup>5</sup>

Even if Mill may have accurately foreseen "the great rapidity with which countries recover from a state of devastation: the disappearance, in a short time, of all traces of mischief done by ... the ravages of war",<sup>6</sup> few in the Europe of 1945 had made such predictions: "the speed of recovery was so impressive as to take by surprise informed observers, trade unions, entrepreneurs and policy-makers alike".<sup>7</sup> And surprise was warranted, not only because of huge domestic dislocation, but also in the light of the external position at the time. While "Europe emerged from the Great War with its overseas investment still large",<sup>8</sup> the virtual disappearance of its overseas assets after World War II severely limited its importing capacity. In addition, the terms of trade, which had worsened by a roughly similar extent during the wars,<sup>9</sup> behaved very differently in the two reconstruction episodes, improving by nearly 18 per cent between 1920 and 1924, but deteriorating by some 6 per cent between 1947 and 1949 and by a further 10 per cent in 1950.<sup>10</sup> Finally, Europe's real exchange rate vis-à-vis the dollar was higher between 1946 and 1949 than it had been between 1920 and 1924 (Figure 2). Indeed, Europe's relative lack of price competitiveness was probably compounded by a severe lack of non-price competitiveness. In areas such as availability and quality, America must have possessed a significantly more pronounced advantage in the late 1940s than in the early 1920s.

One simple domestic reason for the difference in growth rates can be found in the very differing starting points at the end of hostilities.

<sup>5</sup> Svernilson, *Growth and Stagnation*.

<sup>6</sup> Mill, *Principles*, p.93.

<sup>7</sup> Crafts and Toniolo, "Postwar Growth", p.3.

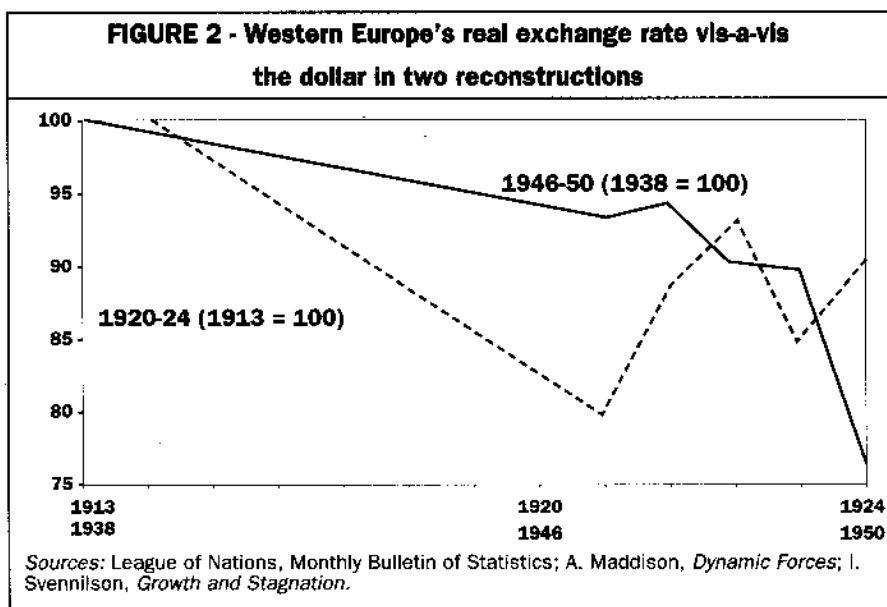
<sup>8</sup> De Long and Eichengreen, "The Marshall Plan", p.200.

<sup>9</sup> Europe's terms of trade worsened by 4 per cent between 1913 and 1920 and by 6 ½ per cent between 1938 and 1947: Kindleberger, *Terms of Trade*.

<sup>10</sup> *Ibid.*

World War II had been much more destructive than World War I. At its lowest point, European GDP in 1919 had reached 90 per cent of its 1913 level, as against only 84 per cent in 1945 of (a below capacity) 1938 level. In other words, the purely physical scope for catch-up was greater in the second half of the 1940s. Yet, "rapid growth after World War II was not mainly a 'rubber band effect' (the reversal of wartime output losses); rather it was sustained acceleration".<sup>11</sup>

Some light on the reasons for this acceleration comes from a consideration of factor supplies. These were higher in 1945-46, relative to the pre-war years, than they had been in 1919. Thus, despite massive destruction "Europe's industrial capacity at the end of the war was larger than before it"<sup>12</sup> and this may well have been true for the whole of the business capital stock thanks to the hefty investments of the war years.<sup>13</sup> No comparable estimates exist for the post-World War I period, but an earlier qualitative judgement suggested that "in 1919 ... the world found itself with its physical capital in bad condition, and in quantity no greater



<sup>11</sup> De Long and Eichengreen, *op.cit.*, p.197.

<sup>12</sup> UNFCE, *Economic Survey*, p.1

<sup>13</sup> Armstrong *et al.*, *Capitalism since 1945*.

than in, say, 1911".<sup>14</sup> Similarly, while the 1919 labour force had been depleted by the massive military losses of the war, that of 1946 was somewhat larger than that of 1938.

Finally, it is very likely that both the capital stock and the labour force present in 1946 embodied higher levels of technology and skills than their counterparts of 1919, if only because of the much greater technological nature of the Second World War compared to the First – the latter had been mainly fought in trenches by peasants with rifles, the former had involved, *inter alia*, mass factory production of research-intensive aircraft and battleships, which required large inputs of skilled manpower to both manufacture and operate.

In addition, there seems to have been a significant difference in the growth of factor inputs through the two periods (Table 3). Though the data do not cover all countries, the differences are sufficiently marked to suggest that both capital accumulation and employment growth were much more rapid in 1946-50 than they had been in 1919-24.

	Europe	France	Germany	Italy	UK
<i>Investment<sup>a</sup></i>					
1920-24	8.5 <sup>b</sup>	10.7	6.0	12.6	6.2
1946-50	11.2 <sup>b</sup>	13.1	7.9	16.1	9.4
<i>Employment<sup>c</sup></i>					
1919-24	0.8 <sup>d</sup>	0.7	1.8	2.8	-0.7
1946-50	3.8 <sup>d</sup>	3.8	3.5	..	3.5
<sup>a</sup> Gross fixed investment in per cent of GNP at current prices. <sup>b</sup> 6 countries: France, Germany, Italy, U.K., Denmark and Norway. <sup>c</sup> Average annual percentage changes. <sup>d</sup> 7 countries: France, Germany, Italy, U.K., Denmark, Netherlands and Norway. <sup>e</sup> 5 countries: France, Germany, U.K., Netherlands and Norway.					
<i>Sources:</i> A. Maddison, "Explaining Economic Growth", <i>Banca Nazionale del Lavoro Quarterly Review</i> , September 1972 (for investment); M. Basle, J. Mazier and J.-F. Vidal, "Croissance sectorielle et accumulation en longue période", <i>Statistiques et études financières</i> , No. 40, 1979; ILO, <i>International Labour Review</i> , February 1951 and September 1952; Maddison, "Economic Growth in Western Europe", <i>Banca Nazionale del Lavoro Quarterly Review</i> , March 1959; N. Rossi, A. Sorgato and G. Toniolo, "Italian Historical Statistics, 1890-1990", University of Venice, Nota di lavoro, No. 92.18, 1992; A. Sommariva and G. Tullio, <i>German Macroeconomic History, 1880-1979</i> (London 1987); U.K. Department of Employment, <i>British Labour Statistics, Historical Abstract, 1886-1968</i> (London 1971).					

<sup>14</sup> Bowley, *Some Economic Consequences*, p.90.

In other words, 1946 Europe had two significant advantages in comparison to the Europe of 1919 as far as its growth potential went: a larger output gap at the outset and a greater capacity to fill it quickly. Yet, such an explanation, however plausible, is only very proximate. For one thing, it is not self-evident that a greater potential is by itself sufficient, in the presence of massive shortages and dislocation, to generate rapid growth. For another, even allowing for greater inputs, the size of the "residual" (or total factor productivity) was almost certainly much larger after 1946 than after 1919. A rough estimate (using a capital-output ratio of 2 and factor shares for labour and capital of 0.7 and 0.3 respectively), results in a residual for Europe (excluding Italy) of nearly 3½ percentage points per annum for the years 1946-50, as against only 1½ per cent per annum in the years 1920-24. Some of this, no doubt, reflects a faster closing of the capacity gap,<sup>15</sup> but other forces must also have been at work.

In addition, neither the faster growth of employment nor the faster growth of the capital stock after 1945 can be taken as fully exogenous. Investment, in particular, tends to respond strongly to accelerator effects (which are endogenous to the growth process) and to expectations about the future (which are likely to be significantly influenced by contemporaneous growth). Hence any explanation for its much higher level post-1946 relative to post-1919, must look at other forces that made for the greater dynamism that was clearly in evidence. For this one must turn to the policy environment, both domestic and international.

## II. Domestic policies

A major difference between the two periods is to be found in the stance of policies. In the aftermath of World War I, "statesmen looked back forlornly and hoped more than they strove to restore the economy

<sup>15</sup> Technological catch-up with the United States might also have been important, but this is likely to have been rapid in both episodes given that Europe was well behind best U.S. practices throughout the period. Maddison's estimates of GDP per man-hour (*Dynamic Forces*) suggest the presence of a gap vis-à-vis U.S. levels of the order of 50 per cent in the early 1920s and 60 per cent in the late 1940s.

of 1913".<sup>16</sup> To this effect, for instance, the Committee of Economic Experts preparing the 1920 Brussels International Conference recommended that "countries balance their budgets, cease borrowing, consolidate floating debt, cut government spending ... and raise interest rates to reflect the real scarcity of capital",<sup>17</sup> all this so as to enable a return to the 1913 gold standard. Interestingly, while the Conference considered such a return "highly desirable" it also admitted that "the reversion to, or establishment of, an effective gold standard would in many cases demand enormous deflation".<sup>18</sup>

After World War II, on the other hand, as presciently already said in 1943: "no one could desire to revive the international economic system of 1939, for there was none – only the ruins of a system. We must look forward".<sup>19</sup> And looking forward meant "that governments will ... accept responsibility for assuring ... the fullest possible employment of resources ... [so] that as and when private initiative proves inadequate, the state must take measures to right the situation".<sup>20</sup> This contrast between the wish to return to the past and the conscious decision to change the future runs through much of the policy debate of the two periods and coloured many of the actions taken, be this at the institutional, at the micro- or at the macro-economic level.

A first area in which differences between the two periods were clear was in the attitude towards war-time restrictions. On the whole, 1919 saw a quick removal of very many of the controls imposed during the war: "the change-over from war economy [was] extremely abrupt. The great mass of the public, impatient to do away with the discomforts of restrictions and to come back to pre-war prosperity, supported the efforts of business to abolish as soon as possible all controls that restricted prices and profits",<sup>21</sup> "although the conditions which [had given] rise to them had by no means passed away and the need for them was perhaps even

<sup>16</sup> League of Nations, *The Transition*, p.13.

<sup>17</sup> Silverman, *Reconstructing Europe*, p.277.

<sup>18</sup> Quoted in Cassel, *Money and Foreign Exchange*, p.213.

<sup>19</sup> League of Nations, *op.cit.*, pp.13-14.

<sup>20</sup> *Ibid.*, p.15.

<sup>21</sup> Alpert, *Twentieth Century Economic History*, p.47.

more acute".<sup>22</sup> The move was rapid in countries as diverse as Britain, Germany, Belgium or even France.<sup>23</sup>

In contrast, the pace of decontrol was much slower after 1945. Most countries retained price and wage controls as well as various forms of rationing at least until the late 1940s; rent and some other controls went on for much longer.<sup>24</sup> Even in those economies in which the pace of liberalization was relatively rapid (Italy and Belgium, or Germany after 1948), it was still a good deal slower than it had been after World War I, despite the understandable reaction of Italian and German public opinion against the regulated economies of the pre-war period. In Italy, liberalization was swift on the foreign trade front, but, bar the freeing of prices, more limited at home,<sup>25</sup> while a battery of controls was still in force in Germany in the early 1950s.<sup>26</sup> Indeed, Germany's "selective liberalization"<sup>27</sup> meant that in the *Sozialmarktwirtschaft* of the early 1950s "the sphere of the state – as controller, redistributor, and probably also as economic manager – [was] larger ... than in the Weimar Republic".<sup>28</sup>

The post-1919 experience was hardly an unmitigated success. Thus, in Pigou's careful judgement, Britain's quick return to the free market was not entirely felicitous: "one broad conclusion can hardly be resisted. With a less impetuous abandonment of [controls] the Government would have had the power ... to enforce some evening-out of industrial activity",<sup>29</sup> thus mitigating, perhaps, the 1919-20 deflation "the intensity of which it would be hard to match from the economic history of the last two centuries".<sup>30</sup> More broadly, the rush

<sup>22</sup> Boulding, *Economics of Peace*, p.48.

<sup>23</sup> See, respectively, Tawney, "Abolition of Controls"; Borchardt, *Grundriss*; Baudhuin, *Histoire économique*; Sauvy, *Histoire économique*.

<sup>24</sup> The post-1945 experience of Japan was very similar. Here too, war-time controls were lifted only gradually and had by no means been fully abolished by 1950. Arguably, such a policy rather than hindering recovery actually promoted it: Teranishi and Kosai, *Japanese Experience*.

<sup>25</sup> Rossi and Toniolo, "Italy".

<sup>26</sup> Stolper *et al.*, *German Economy*.

<sup>27</sup> Hardach, *Wirtschaftsgeschichte*, p.172.

<sup>28</sup> Mendershausen, *Two Postwar Recoveries*, p.71.

<sup>29</sup> Pigou, *Aspects*, p.126.

<sup>30</sup> Hawtrey, *Currency and Credit*, p.415.

to decontrol "in nearly every instance was followed by a sharp and simultaneous price increase and it seems evident that retention of price controls for somewhat longer might have avoided much of the severe spiral in prices".<sup>31</sup> The lesson was learned after 1945 and maintenance of price controls for a number of years allowed inflation to be kept under better check than it otherwise would have been. The premature lifting of such controls was, on the other hand, at least in part, responsible for the Italian inflation of 1947 (as recognized even by Bresciani Turrone),<sup>32</sup> and for that of Germany in the second half of 1948,<sup>33</sup> episodes which were, in turn, followed by sharp moves into restrictive policies.

A second area of much greater post-World War II intervention was in the design of institutions or practices conducive to a more consensual approach to economic policy-making. Attempts to achieve wage moderation, often in exchange for concessions on social security or assurances on full employment or on income distribution, were one such area (e.g. in Austria from the *Grosse Koalition* governments of 1945-46 and in Belgium, Britain, the Netherlands or Norway from 1944 to 1946).<sup>34</sup> More ambitious were attempts to bring the social partners into continuous discussion with each other on issues going beyond wage determination

**TABLE 4. Strike Activity (man-days lost per 100,000 non agricultural wage earners; annual averages in thousands)**

	Europe <sup>a</sup>	France	Germany	Italy	UK
1919-24	172.6	119.6	190.8	149.3	233.2
1946-50	45.8	86.5	3.9 <sup>b</sup>	144.5 <sup>b</sup>	10.0

<sup>a</sup> 9 countries: France, Germany, Italy, U.K., Austria, Denmark, Finland, Netherlands and Norway.

<sup>b</sup> 1949-50 only.

Sources: P. Flora with F. Kraus and W. Pfenning, *State, Economy and Society in Western Europe, 1815-1975*, Vol. II (London 1987).

<sup>31</sup> Aldcroft, *From Versailles*, p.66.

<sup>32</sup> "Italy's Post-War Economy".

<sup>33</sup> Hardach, *op.cit.*

<sup>34</sup> See respectively: Bachinger and Hemetsberger-Koller; "Österreich", Cassiers, "Belgian Miracle"; Tomlinson, "Labour Government"; Klein, "Dutch Prosperity"; Hodne, *Norwegian Economy*.

and involving indicative planning, as in France,<sup>35</sup> or co-determination as in the German reforms of 1951 (whose basis was laid in the late 1940s). And the United States contributed to these developments by advocating a three-cornered partnership for Europe, and insisting on the participation of trade unions in the discussion on the allocation of Marshall Plan funds.<sup>36</sup>

Post-1919 had little that was comparable in part, perhaps, because war-time disruption, which facilitates radical switches to new arrangements,<sup>37</sup> had been less pronounced. It is true that Germany introduced work councils, as well as a shorter working day and week, but the former had much less influence than the *Mitbestimmung* of the 1950s, while the latter was not much enforced.<sup>38</sup> Belgian experience after the two wars was similar.<sup>39</sup> Elsewhere, as well as in Germany, conflict rather than consensus was more frequent. The period seems to have lacked the post 1945 search for institutions and practices designed to defuse social tension, a search which almost certainly laid the grounds for the broadly cooperative behaviour of the 1950s and 1960s.

Some indirect evidence on the effects of such different approaches to consensus building is provided by Table 4 which shows a very sharp decline in strike activity between the two periods. For Europe as a whole, the incidence of labour conflicts seems to have been only a quarter as high between 1946 and 1950 as it had been in 1919-24, and in only one country (Finland) was strike activity greater in the second period than in the first.<sup>40</sup> Slack labour markets (particularly in Germany) must, of course, have been one reason for this relative lack of labour militancy, but unemployment was also widespread in the 1920s yet failed to generate similar docility.

A third and perhaps even more important area of difference lies in the realms of macroeconomic policies. Post-1918 thinking was dominated

<sup>35</sup> Bloch-Lainé and Bouviers, *La France retrouvée*.

<sup>36</sup> Link, "Building Coalitions".

<sup>37</sup> Eichengreen, "Institutions and Economic Growth".

<sup>38</sup> Hardach, *op.cit.*

<sup>39</sup> Mommen, *Belgian Economy*.

<sup>40</sup> The post-World War II data for Germany and Italy cover only the years 1949-50. This should not, however, greatly distort the European total. Strikes in pre-1949 Germany were very limited and a perusal of the *The Economist* magazine for the second half of the 1940s suggests that, in the case of Italy, their intensity may well have been below that of the years 1949-50.

by the “dogma of the gold standard”,<sup>41</sup> a dogma that led to an “almost fanatical belief that monetary and exchange stability must be restored at all costs”<sup>42</sup> - “the notion of wealth generation was virtually absent, eliminated from the debate by purely financial considerations”.<sup>43</sup> Most countries felt that a return to the normalcy of 1913 implied a return to (ideally) the parities of that year or something very close to them. The consequences, in a world in which war-time inflation had been rapid, was an (inevitably self-defeating) attempt to hoard gold and to engage in competitive domestic deflations.<sup>44</sup> Britain, which eventually managed a return to its pre-war gold parity in 1925, was the prime example of a country which sacrificed internal equilibrium for the sake of an overvalued parity and forced itself to follow restrictive fiscal and monetary policies.<sup>45</sup> But deflation was also followed in the neutral countries of Scandinavia and in the Netherlands and to some extent in Italy, at least on the fiscal front.<sup>46</sup>

France, Belgium and Germany went in an opposite direction, but almost inadvertently: “the[ir] more expansionary policies were due more to political inability to establish ‘sound’ financial policies, than to substantial analytical differences from those who inspired British policy”.<sup>47</sup> In France and Belgium fiscal expansion was encouraged by expectations of massive reparations from Germany. In Germany it was imposed by political weakness first and by the French occupation of the Ruhr later – inflation, when it came “was not the result of a policy, but rather a lack of policy”.<sup>48</sup> Interestingly, Germany seems to have benefited from its fiscal laxity until 1922, though the ensuing hyperinflation and

<sup>41</sup> Sauvy, *op.cit.*, Vol.1, p.23.

<sup>42</sup> Aldcroft, *op.cit.*, p.3.

<sup>43</sup> Sauvy, *op.cit.*, Vol.2, p. 79.

<sup>44</sup> Cassel, *op.cit.* It is interesting to realise that Gustav Cassel’s purchasing power parity theory of exchange rate determination was developed in the early 1920s precisely in an attempt to justify existing and not gold standard-based parities at the time – it was a “defense of the *status quo* as against the *status quo ante bellum*”: Samuelson, “Postwar Exchange Rates”, p.397.

<sup>45</sup> Howson, *Monetary Management*.

<sup>46</sup> Cassel, *Monetary Stabilization*; Aldcroft, *op.cit.*; Pedone, “Bilancio dello stato”.

<sup>47</sup> Maddison, “Economic Policy”, p.457.

<sup>48</sup> Laursen and Pedersen, *German Inflation*, p.123.

stabilization caused huge damages to the real economy in 1923-24. As for France and Belgium, they were among the fastest expanding countries over this period (with GDP trend growth rates from 1919 to 1924 of 8.2 and 6.1 per cent respectively), thanks, in part, to their unwitting fiscal stances.

There was, in fact, still little understanding of how economies worked, as shown, for instance, by the widespread confusion on how German reparations were to be effected. Government involvement in the economy had risen sharply almost everywhere (as a result, *inter alia*, of the servicing of vastly larger public debts, of war-related spending and of increased social welfare programmes), but this did not prompt a coordination of monetary and fiscal policies,<sup>49</sup> let alone the acceptance of (*ex ante*) budget deficits. Indeed, simplistic views were widely held by policy-makers such as, for instance, that most economic ills stemmed from fiscal imbalances, that depressions were both necessary and desirable for curing inefficiencies, or that Germany's hyperinflation was caused by currency depreciation, etc.<sup>50</sup>

Attitudes and policies were very different after 1945. Rather than nurturing an obsession with the gold standard, aims shifted towards the maintenance of high employment and/or the encouragement of rapid growth. A number of countries embarked on relatively ambitious expansionary plans in the form of indicative planning for some key sectors. France was the principal example of this, but similar attempts were also made in the Netherlands and Norway. In addition, most countries had to embark on forms of longer-run sectoral investment planning in order to qualify for Marshall aid. Of even greater importance was the stance of demand management which turned out to be a good deal more accommodating than it had been in the early 1920s.

This shift was not primarily due to fiscal policies. Despite claims that the period saw a generalized conversion to the Keynesian idea that the principal aim of policy should not be to balance the budget but the

<sup>49</sup> Bonin, *Histoire économique*.

<sup>50</sup> See respectively: Wolff, "Fiscalité et développement"; Davis, *World between Wars*; Fischer, *Deutsche Wirtschaftspolitik*.

<sup>51</sup> UNECF, *op.cit.*

economy,<sup>51</sup> practice suggests that such principles were applied only consistently in Norway.<sup>52</sup> France and Italy may also have benefited from expansionary stances – though their budget deficits were similar, or even smaller, in 1946-50 than in 1920-24, a rough adjustment for a much higher degree of capacity utilization after World War II<sup>53</sup> suggests that the effects of discretionary policy were stimulating (Table 5). In addition, Italy made a determined attempt, via the 1950 creation of the *Cassa per il Mezzogiorno*, to develop the Southern half of the country. Elsewhere, however, fiscal policy seems to have been relatively prudent. In Britain,

**TABLE 5. Indicators of Fiscal and Monetary Policy**

	Europe	France	Germany	Italy	UK
<i>Budget Deficits<sup>a</sup></i>					
1920-24	..	-7.4	..	-11.9	(0.2)
1946-50	..	-7.9	..	-6.7	-0.5
<i>Real Interest Rates<sup>b</sup></i>					
1920-24	8.9 <sup>c</sup>	3.3	..	-1.1	16.8
1946-50	-10.8 <sup>c</sup>	-23.0	..	-8.2	-5.6
<p><i>Note:</i> in the United States, real interest rates stood at 13.8 per cent between 1920 and 1924 and at -5.5 per cent between 1946 and 1950.</p> <p><sup>a</sup> In per cent of current price GDP</p> <p><sup>b</sup> Bond yields deflated by changes in wholesale prices.</p> <p><sup>c</sup> 5 countries: France, Italy, U.K., Denmark and Norway.</p>					
<p><i>Sources:</i> M. Basle, J. Mazier and J.-F. Vidal, "Croissance sectorielle et accumulation en longue période", <i>Statistiques et études financières</i>, No. 40, 1979; CSO, <i>Economic Trends, Annual Supplement, 1979 and Monthly Digest of Statistics</i>; C.H. Feinstein, <i>Domestic Capital Formation in the United Kingdom, 1920-1938</i> (Cambridge 1965) and <i>National Income, Expenditure and Output in the United Kingdom, 1855-1965</i> (Cambridge 1972); S. Howson, <i>Monetary Management</i>; INSEE, <i>Mouvement économique en France de 1944 à 1957</i> (Paris 1958) and <i>Annuaire statistique de la France</i>, 1996; H.C. Johansen, <i>The Danish Economy in the Twentieth Century</i> (London 1987); League of Nations, <i>Monthly Bulletin of Statistics</i>; J.-F. Patat and M. Luftalla, <i>Histoire monétaire de la France au XX<sup>e</sup> siècle</i> (Paris 1986); F. Spinelli and M. Fratianni, <i>La storia monetaria d'Italia</i> (Milan 1991); Statistik Sentralbyrå, <i>Historik Statistikk, 1968</i> (Oslo 1979); United Nations, <i>Monthly Bulletin of Statistics</i>; U.S. Department of Commerce, <i>Long-term Economic Growth</i> (Washington 1966).</p>					

<sup>52</sup> Hodne, *op.cit.*

<sup>53</sup> Gaps between actual and "potential" output were very roughly calculated by fitting a trend line to the GDP data between 1913 and 1950 (considered years of relatively high employment). For Italy, actual output lies on average some 10 per cent below the trend line between 1920 and 1924 and only 0.7 per cent below it between 1946 and 1950. The differences for France go in the same direction and are even larger.

for instance, its role has been described as “passive, rather than actively disinflationary”.<sup>54</sup>

Much clearer was the pursuit of “cheap money” as indicated, for instance, by the course of real long-term interest rates (Table 5). For those European countries for which data are available, the change between the two reconstruction periods is remarkable (as is also the case for the United States). Accommodating monetary policies after 1945 fed into sharply negative longer-term interest rates, just as tight policies in the earlier episode had kept bond yields high, or even very high.

Germany and Italy are often pointed to as exceptions to this general rule. There was no reflation in Germany on the part of the Allied authorities until mid-1948 and, following monetary reform, there seems to have been a much greater degree of restraint than elsewhere in Europe. As for Italy, it imposed a severe monetary policy squeeze in 1947 to quell inflationary pressures. Yet, both Germany and Italy grew rapidly. In part this stems from relatively expansionary industrial policies in Italy<sup>55</sup> and, despite all, from a cautiously accommodating monetary stance in Germany.<sup>56</sup> More importantly, it seems to have also been helped by “free riding” on the expansionary policies of other countries.<sup>57</sup> The volume of German exports, in particular, soared. Between 1948 and 1950 it rose more than fourfold, as against rises of some 45 per cent for total West European exports and a mere 14 per cent in (non-German) Western European imports.<sup>58</sup> Some of this no doubt reflected a return to more normal trading patterns after the interruption of the war, but rapid demand growth in neighbouring countries is bound to have helped.

<sup>54</sup> Dow, *Management*, p.210.

<sup>55</sup> Hirschman, “Inflation and Deflation”; Prodi and De Giovanni, “Politica industriale”. The Italian paradox was underlined by Hirschman: “In view of these developments it has been observed that the Italian government became involved in the inconsistency of having its Minister of Industry undo what had been done by its Minister of the Budget” (*op.cit.*, p.604). The latter was the liberal economist Einaudi and “it is certainly curious to notice how Einaudi’s ‘orthodox’ policy actually led to more State intervention in, and greater State control of, Italian economic life” (*ibid.*).

<sup>56</sup> Giersch *et al.*, *Fading Miracle*.

<sup>57</sup> Wolf, “Lucky Miracle”.

<sup>58</sup> UNECE, *op.cit.*

Investment must have been stimulated by these various trends. Wage moderation in some countries boosted profits,<sup>59</sup> while low, or negative, real interest rates in most created strong incentives to borrow. In addition, the knowledge that the stance of policy was relatively expansionary is likely to have encouraged entrepreneurial expectations. And selective stimuli to investment were also present, notably in France, because of the plan's avowed aim to raise capital formation, but also in Germany where "until the end of the reconstruction period in 1951, promoting investment was one of the foremost aims of tax policy".<sup>60</sup> Indeed, such was the buoyancy of European investment that encouragement had often to be tempered by restrictions and controls (on imports of machinery or on licensing permits, for instance).<sup>61</sup>

In summary, Europe moved from a policy aimed at attaining external financial equilibrium in the early 1920s to one concerned with internal real equilibrium after 1945. And this policy relied to a much greater extent than before on various forms of direct and indirect government intervention. In part this reflected political changes, but in part it was also dictated by a strong reaction against what had been perceived as the failures of capitalism in the inter-war years. Indicative planning tried to remedy informational inefficiencies. Institutional reform in the wage bargaining area saw that "in the presence of externalities, competitive, decentralized markets did not suffice".<sup>62</sup> And incipient forms of demand management, at work particularly at the monetary policy level, tried to pursue full employment.

Whether these various forms of intervention achieved their aims is difficult to establish with any degree of certainty, as much of the literature provides only broad qualitative judgements. Wage moderation appears to have been successful in improving the inflation-unemployment trade-off at least in Britain in the 1950s and, probably also, in the Netherlands.<sup>63</sup> Institution building in this period laid the grounds for the implicit "social

<sup>59</sup> Armstrong *et al.*, *op.cit.*

<sup>60</sup> Stolper *et al.*, *op.cit.*, p.230.

<sup>61</sup> UNECE, *op.cit.*

<sup>62</sup> Eichengreen, *op.cit.*, p.50

<sup>63</sup> Broadberry, "Unemployment in Postwar Britain"; Haas, "Wage Policy in Holland".

contract" that, it has recently been argued, was such an important ingredient in the successes of the "Golden Age".<sup>64</sup> Planning contributed to fuelling favourable expectations from its beginning, at least in France.<sup>65</sup> And arguments can be found which, in circumstances of generalized under-employment, would justify faith in Keynesian policies of expansion.<sup>66</sup> The pronounced differences in the growth, investment and employment performances between the two periods illustrated above, strongly suggest that this faith could be broadly justified.

### III. International policies

The difference in attitudes between the two periods towards management of the domestic economy finds a number of parallels in the difference in attitudes towards management of the international economy. Here, too, a radical change in the climate of opinion was followed by a radical change in policies, institutions and outcomes.

This was not so much the case for international economic (as opposed to political) cooperation. While the 1950s and 1960s saw a marked growth in such cooperation, in contrast to what happened in the 1930s, the situation in the two immediate post-war periods was more similar. Though attempts were made at the Brussels and Genoa Conferences in the early 1920s, and at the Bretton Woods Conference in the mid-1940s, to lay down some ground rules for international economic behaviour, in the form, in particular, of fixing exchange rates and liberalizing trade, few of these were implemented during the period under examination. If anything, the League of Nations' sponsored rescue of the Austrian economy in 1922 was probably a more successful example of international cooperation, if at the cost of skyrocketing unemployment in that country, than anything attempted in the later 1940s.<sup>67</sup>

Yet, major changes did emerge after World War II which owed a lot to a radically new attitude of the United States towards the world

<sup>64</sup> Eichengreen, *op.cit.*

<sup>65</sup> Carré et al., *La croissance française*.

<sup>66</sup> Boltho, "Policy Activism".

<sup>67</sup> See respectively: Laursen and Pedersen, *op.cit.* and Néré, *La crise de 1929*.

economy. A first very significant difference between the post-Versailles settlement and the post-1945 world was the modesty of the reparations payments demanded from Germany and the near-absence of American claims for the repayment of war debts from Europe. While reparation and debts had "complicated and corrupted the international economy at every stage of the 1920s",<sup>68</sup> this millstone round Europe's neck was virtually absent in the later 1940s.

On the contrary, the United States provided substantial aid to war-destroyed Europe, first in the form of UNRRA relief and later via the Marshall Plan. While some help had also been forthcoming in 1919, in the form of food shipments, this was short-lived, almost entirely extended through loans rather than grants, and quantitatively much less significant than the assistance provided after 1945. It may well be true, as has been argued more recently, that Marshall aid was not crucial to Europe's recovery as earlier thought.<sup>69</sup> Yet, Marshall aid did fulfill some useful purposes. First, by raising the size of the pie it may well have facilitated the achievement of a consensus on how to distribute this pie.<sup>70</sup> Second, it encouraged, indeed at times imposed, European cooperation.<sup>71</sup> The intra-European contacts and the mutual trust that were established in these years must, in turn, have contributed to the later successes of the European Payments Union (EPU) and of the Common Market and stand in marked contrast to the early 1920s when political and economic conflicts between the major European powers were widespread.

It has also been argued that Marshall aid may have allowed the United States to prompt the European countries into less interventionist policies than those they would otherwise have followed.<sup>72</sup> This claim is debatable. Most countries were usually able to resist American pressures for a quicker removal of war-time controls, be it for political or bureaucratic reasons.<sup>73</sup> And the Americans themselves were divided on the need for such

<sup>68</sup> Kindleberger, *World in Depression*, p.23

<sup>69</sup> Milward, *Reconstruction*.

<sup>70</sup> Eichengreen and Uzan, "Marshall Plan".

<sup>71</sup> Hogan, *Marshall Plan*.

<sup>72</sup> De Long and Eichengreen, *op.cit.*

<sup>73</sup> Esposito, "Influencing Aid Recipients".

pressures. While the U.S. Treasury followed an orthodox line and was ready to countenance European deflation for the sake, for instance, of a return to convertibility, most of the administrators in the Economic Cooperation Agency (ECA), which supervised Marshall aid, were themselves Keynesian New Dealers who endorsed reflation and were usually sympathetic to Europe's pro-investment policies.<sup>74</sup> Thus, "Marshall planners would use counterpart funds to supplement capital formation, to offset deflationary impacts on output and employment, and to educate participating governments in American strategies of macroeconomic management".<sup>75</sup> Their sharp criticism of Italy's deflationary policies in 1947 was a case in point,<sup>76</sup> as was their (unheeded) encouragement of more stimulation in Germany.<sup>77</sup>

Where, however, both the U.S. Treasury and the ECA saw eye to eye was in the need to liberalize foreign trade. In Marshall aid they had an instrument with which to cajole Western Europe in complying. There had been nothing of the sort in the early 1920s when the world "lacked any institutional mechanism to facilitate the reduction of trade barriers".<sup>78</sup> Thus, war-time controls, which had been swiftly abolished at home, were often maintained on international trade, until, at least, 1927.<sup>79</sup> Moreover, the period also saw a generalized escalation of tariff protectionism in Europe.<sup>80</sup> France restricted trade in 1919, Italy adopted high tariffs in 1921, Britain strengthened the trade restrictions it had taken during the war, the various countries that arose out of the breakdown of the Austro-Hungarian empire engaged in fierce economic nationalism, and the United States, of course, imposed very high duties in 1922.

The later 1940s saw broadly opposite developments. Tariff and quota dismantlement were slow initially (their acceleration dates from the 1950s thanks to the establishment of the EPU first and of the Common Market later). Yet, the GATT achieved one significant round of tariff reductions

<sup>74</sup> Maier, *Search of Stability*.

<sup>75</sup> Hogan, *op.cit.*, pp.152-53.

<sup>76</sup> *Ibid.*

<sup>77</sup> Abelshauser, "American Aid".

<sup>78</sup> Irwin, "GATT's Contribution", p.127.

<sup>79</sup> Loveday, *Britain and World Trade*.

<sup>80</sup> Bairoch, *Economics and World History*.

already in 1947-48. The United States made by far the largest concessions, but it was joined by the Benelux and Scandinavia.<sup>81</sup> More importantly, two-thirds of intra-OEEC trade had already been freed from quantitative restrictions by the end of 1950<sup>82</sup> and commitments had been made to increase that share. Even as traditionally as protective a country as France had come round, in the late 1940s, towards a “soft” form of trade liberalization.<sup>83</sup> The whole process was, of course, far from linear. There were numerous set-backs, with protectionist measures in many countries first abolished and then reinstated (e.g. in 1951), yet the broad trend was unmistakable.

The experience regarding controls on capital movements was almost opposite. After World War I, as part of the general retreat from war-time interferences, most exchange controls were quickly removed. By allowing unfettered flows of “hot money”, this contributed to the exchange rate gyrations of the early 1920s.<sup>84</sup> After World War II, by contrast, many of the controls of the 1930s and of the war years were maintained and currency movements were severely restricted. Indeed, current account convertibility was only introduced in 1958, and in some European countries the full restoration of free capital flows had to wait for the early 1990s.

International attitudes had clearly changed radically on both sides of the Atlantic. The United States moved from the insular economy of the 1920s, which had raised its tariffs against the rest of the world and had requested the payments of its claims on it, to an open world leader in the 1940s, extending generous assistance to Europe, accepting trade discrimination against its own goods, and welcoming, indeed encouraging, Europe’s 1949 devaluation.<sup>85</sup> And Europe moved from acute Franco-German (and continuous Franco-British) rivalry in the early 1920s towards the much greater cooperation of the later 1940s. A major beneficial consequence of these various trends was a gradual, if initially

<sup>81</sup> See respectively: Irwin, *op.cit.* and Diebold, *Trade and Payments*.

<sup>82</sup> OEEC, *9<sup>th</sup> Report*.

<sup>83</sup> Bossuat, *La France*, II, p.694.

<sup>84</sup> Nurkse, *International Currency Experience*.

<sup>85</sup> Van der Wee, *Prosperity and Upheaval*.

only slow, acceptance of the desirability of freer international trade, coupled with a willingness to restrict unfettered movements of short-term capital. Clearly, many of the lessons of the 1930s had been learned.

## Conclusions

That the reconstruction years after World War II were much more successful from an economic point of view than those following World War I would seem to be a generally accepted conclusion. Growth was more rapid and unemployment fell, while it had risen in the earlier episode. In addition, domestic cooperation between the social partners, as well as international cooperation within Europe and across the Atlantic, were strengthened thus laying the institutional foundations for the subsequent "Golden Age". The 1920s, on the other hand, saw continuing economic and social tensions. Political differences can hardly explain this contrast since "each period witnessed a [similar] swing from radical challenge to political consolidation".<sup>86</sup> Social changes were probably more pronounced after 1945 than they had been after 1919, notably in those countries which had been defeated. This may have stimulated growth in the second episode under review by weakening what have been called "distributional coalitions" – that is organizations such as trade unions, oligopolies, farmers' associations, etc. – whose main aim, it has been argued, is not so much wealth creation as income redistribution.<sup>87</sup>

Turning to economic variables, different starting points and a more favourable endowment (and growth) of factors of production throw some light on the reasons for the different outcomes. Yet, the most important single discriminating factor which clearly distinguishes the experience of the two periods is the extent and nature of government intervention in the economy. On the one hand stood the dogmatic 1918 belief that a return to past liberal practices was possible, despite the great changes that the war had wrought; on the other the much more pragmatic 1945

<sup>86</sup> Maier, *op.cit.*, p.155.

<sup>87</sup> Olson, *Rise and Decline*. It should be noted, however, that the Olson thesis has been put into doubt in the case of the one European economy that would seem to best fit it, namely West Germany: Paqué, "Why the 1950s and not the 1920s?".

conviction that looking back was a recipe for failure and that, therefore, major, and as yet unexplored, changes had to be made to how economies were going to be managed. The contrast between the 1918 Cunliffe Report (which advocated a return to the pre-war Gold Standard) and the 1942 Beveridge Report or the 1944 White Paper on Employment Policy (which advocated the creation of a welfare state and of a new economic system) epitomizes this difference in Britain. In France, it is shown by the contrasting attitudes of Clemenceau, whose main goal was the reconstruction, along pre-war lines, of war-devastated areas (to be paid for by Germany), and Monnet, whose first five-year plan's aims were: "increase output, ... productivity, ... ensure full employment, ... raise living standards".<sup>88</sup>

Internationally, there was a similar realization that cooperation had to be sought if one wanted to avoid the mistakes of the 1930s. The Cold War helped, of course, in imposing this cooperation, both within Western Europe and between Western Europe and the United States. While the military occupation of the Ruhr in 1923 destroyed what was left of Germany's public finances, the Berlin blockade of 1948 reinforced the cohesion of the Western alliance and facilitated America's efforts to strengthen intra-European cooperation. But the Bretton Woods blueprint, completed prior to the outbreak of major tensions with the Soviet Union, had shown that agreement on much greater international economic cooperation had already been established.

Implementation of these different aims took the form of very different attitudes to economic policy making. In contrast to the "big bang" like abolition of most forms of war controls that prevailed after 1918 (with the significant exception of controls on foreign trade), much greater micro-interventionism was maintained for much longer after 1945 (though American insistence on freer trade led to some incipient liberalization in this area from 1947 onwards). In contrast to a world in which conflicts over work and pay were endemic, came conscious institution-building designed to elicit cooperation between the social partners. And in contrast to macroeconomic policies that were primarily designed to preserve

<sup>88</sup> Monnet, *Mémoires*, p.284.

external equilibrium, budget balance and low inflation came policies aimed at high investment and high employment. In short, the early 1920s saw a combination of *laissez faire* at home and trade interventionism abroad, while the later 1940s witnessed an almost opposite mixture.

Like all generalizations, this oversimplifies the situation. Not all controls were removed immediately in 1919, nor did all countries at the time yearn for the liberal order of 1913.<sup>89</sup> Similarly, maintenance of controls after World War II was not everywhere seen as desirable, or even inevitable. Nor did all countries follow the same policies. Germany, in particular, was a partial exception on both occasions, wildly inflating in the early 1920s and maintaining a broadly non-interventionist stance after its 1948 monetary reform. Social conflicts were numerous in the late 1940s, at least in some countries, and business opposition to the new policies was widespread. Mistakes were clearly made in the more recent period (witness Britain's premature rush to convertibility in 1947), too many sectors were nationalized for political rather than for economic reasons, bureaucratic interference often reinforced inefficiencies, and the liberalization of international trade was a slow process, with nearly as many set-backs as advances. Indeed, trade was still probably more controlled in 1950 than it had been in 1924. Nor were policies as carefully selected as is perhaps being suggested. In the first three years after 1945: "there was less decisive purpose than confused experimentation and uncertain initiatives".<sup>90</sup> Yet, "the shift of emphasis towards investment, growth and high employment as prime objectives of policy became more marked as the immediate post-war upswing pursued its course".<sup>91</sup>

It is primarily on this shift that attention has been focused. With the benefit of a hindsight that follows on the achievement of full employment and on two major oil shocks, demand management and *dirigisme* have been criticized as being both impotent and inflationary. Yet, at the time, they looked innovative, promising and broadly credible. This must have acted favourably on expectations, while the alternative policy course was in most minds associated with the failures of the inter-war period.

<sup>89</sup> Fischer, "Wirtschaft, Gesellschaft und Staat",

<sup>90</sup> Maier, *op.cit.*, p.173.

<sup>91</sup> Milward, *op.cit.*, p.37.

It is this contrast between the incipient Keynesianism, and the incipient moves towards free trade, of the post-World War II years, with the gold-standard-inspired deflations and the pervasive protectionism of the years which followed World War I, which goes a long way in explaining why the post-1945 episode turned out to be, by the standards of the post-1918 one, such a resounding success.

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