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SUMMARY OF THE  
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ECONOMIC COMMISSION FOR EUROPE  
REPORT ENTITLED

"A SURVEY OF THE ECONOMIC SITUATION AND PROSPECTS OF EUROPE"

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A SURVEY OF THE ECONOMIC SITUATION AND PROSPECTS OF  
EUROPE

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A SURVEY OF THE ECONOMIC SITUATION AND PROSPECTS OF  
EUROPE

The following paper attempts to summarize the most important ideas and a few of the facts contained in the voluminous report prepared by the Research and Planning Division of the Economic Commission for Europe.

Emphasis is laid in the report on the dominant features of Europe as a whole rather than on separate problems in individual countries. Overall estimates exclude almost always U.S.S.R., very often Yugoslavia and Rumania. However, 70 to 80% of pre-war industrial production, and up to 90% of agricultural production are accounted for.

The report is divided in four main parts:

- 1) The recovery in production.
- 2) The recovery in trade.
- 3) The balance of payments.
- 4) Problems of European reconstruction.

and two important Appendixes, namely:

- A) Economic Plan of European countries.
- B) Notes on sources and methods.

The report includes 96 tables, 9 charts and over 300 pages of text.

In most cases figures and text refer to Europe as a whole and it is hardly even possible to distinguish accurately between C.E.E.C. countries and the others. If such a distinction could be made, many problems would probably appear in a different and often more favorable light.

In view of the delay involved in publishing most official data the report actually refers to the period ending during the fourth quarter of 1947 and contains no new facts relating to 1948.

## PART I

### THE RECOVERY IN PRODUCTION

#### 1) Industrial Production

For fifteen European countries representing 75% of the total value of pre-war European industrial production, the average level of production rose from 60% of pre-war in the latter half of 1945 to 83% including and 98% excluding Western Germany for the period October 1946 to October 1947. There were considerable differences in performance (over a range of about 40% outside of Germany). Nevertheless the rate of recovery was on the whole surprisingly rapid up to the end of 1946. But no further considerable progress was made during 1947. Underlying causes of this stagnation can be laid only partly to temporary factors such as the fuel shortage. In addition, there was a shortage of raw materials, resulting in critically low levels of stocks, impeding further expansion. The stock position has improved in the course of 1947, but progress in the coming year cannot continue at the 1945/46 rate, as more normal levels have now been attained (with the conspicuous exception of Germany.) As higher percentages of pre-war production are attained, the current rate of progress diminishes: in countries where production was under 70% of pre-war, the average gain during 1946 was over 53%; in the intermediate group where the production index stood between 70 and 100%, the average gain was 29%; in the countries whose level of output was above 100%, the improvement was only 17%.

If individual industries are considered, production of investment goods industries appears to have risen much faster than that of other industries: by 32% in the course of 1946 as against 19% for other industries. This increase continued in 1947, even after the general increase had stopped. However, it must be noted that for the group of countries shown, investment goods output was low in 1938.

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#### 1) Industrial Production

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## 2) Agricultural Production

Recovery in agriculture was, by no means, as favorable as in industry: only 63% of pre-war were produced during 1945-1946 and 75% in 1946-1947. In the current year 1947-1948, production will be appreciably below this last level. The causes, apart from weather conditions, are the prolonged lack of fertilizers, the losses in livestock and equipment, and the scarcity of agricultural manpower. Only in Ireland, Sweden, Turkey and U.K. did production reach the pre-war levels. In former surplus areas of Eastern Europe, production was only 60% of pre-war.

The fall in agricultural production between pre-war and 1946-47 was uneven: almost 40% for animal products (meat, eggs, butter, milk), 23% for potatoes, 20% for sugar, less than 20% for wheat. Production of tobacco was maintained. Due to the decrease of animal product's share in total production, the calorific value of supplies appears to have diminished less than the value of gross output.

## 3) Transport

Railway transport made a remarkably quick recovery, and goods traffic was (in the thirteen countries where data are available) 26% over pre-war. However, railways operate under heavy strain, for the following reasons:

Reduction of inland water traffic, increasing the share of railways in total transport.

Increase in length of haul. This increase is a partial result of the reduction in inland water transport, shifting towards railways long distance traffic formerly carried by barges. It also reflects a more important fact: the general fall in productivity of the European industry, calling on distant and relatively poor sources of supply, deprived of sufficient or adequately dispersed stocks, and therefore obliged to meet higher overhead costs of transport (examples: cross hauls of coal, fuel wood consumption and northward shift in logging in Finland).

4) A Comparison with Post World War I

The rate of industrial recovery was definitely higher after World War II than after World War I. Fourteen months after the cessation of hostilities, the weighted averages of industrial production indexes in 10 countries were 83% in 1920 and 95% in 1946-47 (July-June). While Germany and Italy fared much worse after World War II, Belgium, France, U.K. and Poland fared much better.

Coal production, despite the fall in German output, reached in 1947 almost the same relation to pre-war as in 1920. But consumption was higher: 94% instead of 86%, reflecting greater industrialization in coal-importing countries. Also, the exportable surplus that Europe had in 1913, to cushion the production losses during the war, had diminished in 1938. These two reasons account for the coal shortage and imports of 29 million tons in 1947 as against 8 million after World War I. The picture was substantially similar for steel: despite a German production of 15% only of pre-war in 1948, aggregate European production in 1947 was 65%, the same as in 1920 (and 100% if Germany is excluded).

"Better planning and organization" after World War II have made possible this quicker recovery in production. It is hoped also that European nations are now far better equipped to avoid a depression like that of 1921 which caused a severe setback in recovery.

The decline in agricultural production in 1946/47 relative to pre-war was not greater than after World War I, but in 1947-48 bread grain production at least was at lower figures, both absolutely and in percentages, than in any year after World War I. And because of the decline of per capita European supply that occurred in the inter-war period, a similar percentage decline now means lower absolute levels of consumption. Since the first war,

European production never caught up with the growth of population. Even if pre-war agricultural output is restored, as planned, by 1950-1951, this will still mean a 6-8% per capita decrease from the 1934-1938 levels, owing to the increase in population.

#### 5) Changes in Available Resources

In order to show the overall and per capita change in available resources at home, it is necessary to go beyond usual index number comparisons. Imports must be added to, and exports subtracted from the total value of home production, estimated at constant prices <sup>1/</sup>. The concept used in the report is that of "commodities available for home use"; in other words, an estimate of gross national product that would exclude all services and to which the net commodity import balance, if any, is added. By putting side by side the total value of home production and the overall and per capita figures so obtained, it is possible to gain an impression: 1) of individual national recovery, 2) of the physical amount of external resources received by each country (be it with or without immediate payment), and 3) of the goods available per person (be it for consumption or for investment).

From the figures for 1946/47 (July-June), it can be seen that while home production was constantly under pre-war level <sup>2/</sup> the "supply of commodities for home use" was generally above, except in the case of Finland (reparations) and of the U.K. (relative decrease in import surplus). If population changes are now brought into the picture, Bulgaria, Denmark, the Netherlands, and

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<sup>1/</sup> The total obtained can then be divided by the population figure to show availabilities per capita.

<sup>2/</sup> Except in U.K., Ireland, Sweden and Norway.

Western Germany with large increases in population appear relatively worse off, while Poland and Czechoslovakia, with large decreases, appear relatively better off, in terms of per capita resources.

The most conspicuous example of the combined effect of trade and population on per capita available goods is probably the U.K., where home production is 108% of pre-war, while resources per head are 91% only.

Of course, if individual well-being is to be estimated, "available resources" per capita are not determinant. The share of investments and of government expenditure in the gross national product must also be determined. As this share has generally increased, the standards of consumption are lower than figures of commodities per head would indicate.

#### 6) Manpower and Productivity

The total population of Europe remained unchanged between 1938 and 1946 (380 millions). The population of working age also remained the same, but the number of men has decreased. The proportion of women in the occupied population has increased. Occupational distribution figures show a sharp increase in services (government and commerce) offsetting a decrease in agriculture, the numbers in industry being left unchanged. Apart from Germany and Italy, there is a large increase in employed population: 4% for 12 countries representing 1/2 of European population. Working weeks (particularly in France) are longer. There has been a shift from heavy to light industries (coal and agriculture are undermanned).

Apart from these absolute changes, productivity per man-hour is definitely lower than pre-war (while it has increased by 27% in the U.S.). One of the reasons for this is that when shortages, e.g. of raw material and fuel, are felt, employment of workers is maintained. Thus a considerable but

hidden unemployment appears in the labor force, and when output falls, productivity, not employment, falls with it. In addition, other factors (probably more important in 1947) were the obsolescence of capital equipment and the general disorganisation due to inflation and trade restrictions. A study would be necessary to determine what is under-capitalization and what is disorganization. Manpower shortages in particular industries may be eased through the encouragement of international migration.

## PART II

### THE RECOVERY OF TRADE

#### 1) The Current Level of Europe's Trade

The percentages of intra and extra-European trade compared to 1938 are, in real terms, as follows for 1946 and 1947:

	1938 = 100					
	<u>Intra-European Trade</u>		<u>Trade with non-European Countries</u>		<u>Total Trade</u>	
	<u>1946</u>	<u>1947 <sup>1/</sup></u>	<u>1946</u>	<u>1947</u>	<u>1946</u>	<u>1947 <sup>1/</sup></u>
Imports	45.3	56	91.9	106.5	66.5	79.0
Exports	45.3	56	61.7	77.7	51.0	63.6

Europe's total trade is thus well below 1938 levels, only imports from overseas being somewhat higher in 1947. There was in 1947 substantial expansion over 1946, but the increase in imports was greater than that in exports, making for a larger disequilibrium.

The rate of increase in trade (especially exports) slowed down in 1947, like in the case of production. It was very uneven: the U.K. and Finland have been in the unique position of having exports rising more than imports,

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<sup>1/</sup> Excluding Germany, the index of total exports (for the 9 first months of 1947) would be 88 and for total imports 102.

while in other countries the reverse is true.

Volume indices may be estimated as follows for the first 9 months of 1947:

European Trade (1938 = 100)

	<u>Imports</u>	<u>Exports</u>
Total trade including Germany	79	63
Total trade excluding all trade by and with Germany	102	88

2) Trade in Relation to Production

a) Trade and Production

If the changes in the ratio of export index to production index are considered, it can be seen that exports have in 1946 and 1947 fallen more than production. There was an improvement at the end of 1946, which disappeared in early 1947, the 1946 level being regained, however, in later 1947. (The ratio was 61% at the beginning of 1946, 86% at the end of 1947.) The ratio of exports and imports to "commodities available" (in the sense explained in Part I above) shows that only the U.K. succeeded in increasing the pre-war export ratio, while cutting that of imports. In all other countries, the ratio of exports to "available commodities" has fallen. In some countries (Sweden, Norway, for instance), it is striking to note that, despite little or no war damage, there was a decrease in exports of some 30%, while imports remained at or above pre-war levels in both absolute and relative terms.

3) Geographic Distribution

A general double entry table gives the distribution of Europe's trade by country groups in 1928, 1938, 1946 and 1947. The main conclusions that can be drawn are as follows:

a) As shown above <sup>1/</sup>, there has been a sharp decline in intra-European trade compared with total European trade. The main areas responsible for this decline are: Germany (with the major influence in this respect), Central and Eastern Europe, and the United Kingdom in so far as its imports from Europe are concerned. Imports of European source also declined in Iberian and Mediterranean Europe. Western European and Scandinavian trade with the rest of Europe also was reduced in both imports and exports, mainly as a result of the disappearance of German trade <sup>2/</sup>.

b) The percentage of Europe's overseas exports going towards countries affiliated with European currency regime increased. Exports did not recover towards the U.S. The U.K. accounted for nearly 45% of overseas exports. The greatest contraction is again a consequence of the elimination of Germany. Total exports to non-European countries in 1947 were 77% of 1938.

c) Europe's imports from overseas were higher than pre-war, but unevenly distributed (lower in Germany, equal to pre-war in U.K., much higher elsewhere), Imports from the U.S. were in real terms twice as large in 1947 as in 1938. Imports from other countries were at most 85% of pre-war.

d) Europe's trade compared to world trade is much smaller than pre-war. The share of Europe in total exports was 54.9% in 1947 as against 63% in 1938, and in total imports 46.9% as against 55%, a decline of around 15% in both cases. (Intra-European trade is 17% of world trade instead of 30%). Europe's competitive position in overseas markets is drastically altered. In 1947 U.S. total exports outside Europe were larger than all combined exports of European countries, while before the war the latter total was more than three times the former. Europe is in deficit with the three other main trading

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<sup>1/</sup> Page 6.

<sup>2/</sup> It must be remembered that there has been a substantial recovery of intra-trade within Western Europe (approximately 90% of 1938 for the 16 ERP countries, excluding Western Germany).

areas of the world: in 1947 by \$4,900 million with U.S., \$1,600 million with Latin America, Canada and the Far East, and \$380 million with affiliated currency areas.

#### 4) Commodity Changes in Europe's Trade

Instead of importing primarily raw materials and unprocessed foodstuffs from overseas countries (outside of the United States), Europe now imports large amounts of grain, coal, processed foodstuffs, and also of manufactured goods and capital equipment items (mainly from the U.S.). This reflects temporary emergencies (coal, grain, extraordinary capital requirements), and also, but to a relatively small extent, the fact that a diversion towards the U.S. has become necessary with the disappearance of former sources of supply (for bread grains and coarse grains particularly). A reduction in imports has occurred when no diversion to U.S. was possible (Asiatic oil seeds and nuts), and also as a result of foreign exchange shortages (tea and coffee imports).

Imports of raw materials and manufactures have been more generally maintained than imports of foodstuffs, but their composition has changed: reductions in timber, cotton, chemicals and fertilizer being offset by increases in petroleum. All reductions in imports are likely to be only temporary.

In respect to exports, there has been a sharp reduction from pre-war shipments of raw materials and foodstuffs, more severe in intra-European trade than in exchanges with hard currency areas, colonial areas, or the U.S.S.R. Manufactured goods have recovered in trade with non-European countries (specially machinery and vehicles where exports are at or above pre-war level). Intra-European trade in manufactured goods has declined much more sharply, more as a result of Germany's elimination than from any other causes, since most of German trade in manufactures was directed towards Europe. This has been

compensated to some extent by increased exports of other manufacturing countries. But in most manufactures (particularly iron and steel, textiles, and chemicals) intra-European trade remains far below pre-war levels.

### PART III

#### THE BALANCE OF PAYMENTS

A total deficit of 7,500 millions of current dollars is the most critical feature in Europe's present economic situation. Three main questions arise in this respect:

What are the factors responsible for the deficit?  
How was the deficit financed?  
How can equilibrium be restored?

1) What are the factors responsible for the deficit

a) Change in invisible items: The loss on income from investments alone is about \$1,000 million. On shipping and other services, Europe's position has become sharply adverse, at least temporarily, due to losses in tonnage, overseas public expenditure, and fall in tourist receipts. Thus, in place of the \$700 million of net receipts from these items in 1938, there was a net outlay of \$1,000 million in 1947 (a total impairment of \$2,700 million).

b) Change in real volume of merchandise trade: The remaining \$4,800 million of the deficit arise from 1) changes in volume and 2) changes in prices of exports and imports. Changes in volume account for \$1,200 million (\$800 million less exports, \$400 million more imports). Elimination of Germany explains 75% of the loss in exports (\$600 million), but as this is nearly offset by the present reduction of imports into Germany (\$500 million) the problem of coping with the overall European deficit may be considered apart from the special and acute German problem.

c) Changes in prices account for the other \$3,600 million. Taking Europe as a whole, this is not due to a deterioration in the "terms of trade", which have in general not changed significantly (the United Kingdom being a notable exception). But the post-war rise in prices, even when equal for exports and imports, has affected more the swollen imports than the depleted exports. If changes in "average values" <sup>1/</sup> of actual exports or imports are considered, it can be seen that the cost of imports in terms of exports has risen for the U.K., and fallen on the average for Continental Europe, the changes cancelling out for Europe as a whole. It should not be concluded, however, that this "favourable" change in Continental Europe's terms of trade cannot have very unfavourable effects by limiting the possibilities of marketing Europe's exports at their inflated prices, in hard currency areas.

In this respect, the report states that Europe cannot reasonably expect a fall in the price of its imports, while maintaining that of its exports, if the volume of the latter is to rise. The necessary reduction in export prices may well offset a fall in import prices and equilibrium will have to be attained by purely quantitative measures: export drives or import cuts.

A comparison with the aftermath of World War I reveals the relative success of Europe's efforts towards self-help in the field of current trade: 45% of imports were bought by exports in 1947 as against 39% only in 1920. But the great deterioration of invisible receipts explains why the increase in the real volume of imports received by Europe in the second post-war period is less than might be expected from the expanded scope of financial

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<sup>1/</sup> The "average value" index compares the value of actual trade in a given year with the value of actual trade in the base year. Changes in "average values" are more instructive than changes in price alone, because they account for changes in the composition of trade.

assistance: there was only 30% increase over 1920 in total imports (and 44% in imports from the U.S.). . .

The strain on the U.S. economy, as expressed by the relation of surplus exports to Europe to total U.S. output has been only less than half as large as after World War I (2% of gross national product in 1947, 5% in 1920). But, after World War II, Europe was not the only claimant on U.S. resources, and its share in total U.S. export surplus was less than 50%. Despite this fact, however, total U.S. export surplus in 1946 and 1947 together was a lesser part of production than in 1919-1920. Another notable fact is the progressive decline in the ratio of U.S. imports to U.S. production (5.2% in 1919-1920, 3.4% in 1921-1939, 2.4% in 1946-1947).

2) How was the deficit financed

To calculate the amount to be financed, it must be noted that in addition to the trade deficit, there have been heavy payments on capital account: for the U.K. alone \$1,274 million in 1947 for reduction of sterling balances, and other movements towards the sterling area. In addition, subscriptions to the Fund and the Bank totalled \$503.9 million (end of June 1947), total which goes far to offset the \$938 million of financial assistance extended by both institutions until December 1st, 1947. By and large, gross capital transfers from Europe in 1946-1947 are estimated at nearly \$2,000 million.

The financing of the 1946 current account deficit is estimated as follows:

UNRRA aid and other grants	-	\$2,300 million	
Loans and credits (net)	-	\$2,500	" 1/
Use of European assets	-	<u>\$1,000</u>	"
		\$5,800	"

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1/ Excluding war surplus credits.

The financing of the 1947 deficit cannot yet be comprehensively described in numerical terms. However, the following conclusions stand out clearly:

a) Financial requirements were much higher than in 1946. They probably exceeded \$9,000 million on current and capital account (because of increased deficit, rise in prices, capital payments).

b) These requirements coincided with a period of sharp contraction in post-war aid to Europe (end of UNRRA, suspension of loans between the U.K. loan of July 1946 and the first I.B.R.D. loan in May 1947).

c) 60% of the \$9,000 million requirements mentioned above were met from the following sources:

	(millions)
Use of gold stocks and dollar balances	\$1,800
Drawings from the Fund (up to December 1st, 1947)	441
U.S. and Canadian credits	<u>3,270</u>
Total	\$5,511

At the end of 1947, pending the realisation of the E.R.P. (referred to as a: "plan for comprehensive financial aid coordinated with economic recovery"), \$532 million of interim aid to France, Italy and Austria were appropriated by the United States. The report notes that prospects of comprehensive assistance had "the unfortunate consequence that existing institutions established to provide long-term international financing have tended to suspend new lending operations for the time being, thus aggravating the dollar crisis".

### 3) Possibilities of restoring international balances

Europe's merchandise trade account must bear the main burden of adjustment for the following reasons:

First, net investment income is more likely to fall than to rise, as Europe's assets shrink and its debt increases. Second, a major increase in income from services is doubtful (tourism is the best hope). Total net receipts from invisibles cannot be counted upon to yield more than \$500 million. Large outflows of capital are to be foreseen (release in sterling balances, amortization of loans). Thus, adjustments in merchandise account are needed, the size of which can be estimated (in 1938 prices) at \$2,000 million (1938 levels of trade) or \$3,300 million (1947 levels). Equilibrium at 1938 levels would imply a 56% increase in exports, a 36% contraction in imports, or some combination of both <sup>1/</sup>. In the special case of U.K. exports, volume would have to be roughly 175% of 1938 to secure the 1938 import volume. The U.K. deficit is a major part of European deficit, and its elimination would leave only a gap of \$300 to \$400 million in overseas accounts of other European countries. But to the extent that U.K. had a trade deficit with other Europe (\$600 million in 1938), adjustments by U.K. alone would simply transfer the problem to other countries.

To state these figures is enough to realize the magnitude and difficulties of the problem of restoring equilibrium. It can clearly not be solved in a short period, nor by making adjustments on only one side of the trade account.

#### Possibilities of export expansion

An increase in exports of more than one-third would eliminate trade deficits with overseas countries outside of U.S., but would effect only

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<sup>1/</sup> Given the temporary nature of some of the import needs in 1947 (coal, grain, reconstruction items), it seems more realistic to calculate the adjustments required to eliminate the 1938 trade deficit. To eliminate the 1947 deficit would require a 114% increase in European exports, or a 53% decrease in imports.

a moderate reduction in deficit with U.S. (only 14% of 1947 exports went there). Possibilities of triangular or multilateral settlements between Europe and U.S. are very unpromising because of the adverse balances of non-European countries with the U.S. (Import surplus problems are by no means a purely European feature). The expansion of direct European exports to the United States is not very promising either, at least in the magnitude required. If European currency inflation is cured, however, and if determined efforts are made to expand European markets in the U.S., progress may be made towards closing the gap by exports of luxury and light industries goods. This process will require the full co-operation of the United States. Apart from the U.S. market, the bulk of any increase in exports will have to come from European heavy industries, whose markets may expand with the industrialization of undeveloped areas.

#### Possibilities of import contraction

Europe's present imports may usefully be divided in three broad categories: "normal" imports (foodstuffs and raw materials), "relief" imports (coal, bread grains, processed foodstuffs), "reconstruction" imports (capital equipment). The first category is incompressible, and is indeed bound to increase be it only for sound economic reasons (increased production and exports) or for economically more doubtful purposes (shifts from coal to oil). Additional import requirements in this category are estimated to some 300 to 400 million dollars at pre-war prices coming over and above the pre-war deficit of \$2,000 million. On the other hand, the other two categories can reasonably be expected to disappear. It must also be noted that before the war Europe imported some \$500 million of engineering and chemical goods from the U.S., and in that case substitution towards European heavy industries appears possible.

The conclusion may be drawn that to balance ultimately overseas accounts and yet restore pre-war standards of living, the following steps must

be taken in Europe:

- 1) The production of heavy industries must be expanded by some \$2,000 million pre-war dollars, both to substitute for manufactured goods hitherto imported and to increase exports.
- 2) The remainder of the adjustment will have to be made by increased exports of luxury goods and light industrial products to the U.S., and to the extent possible, by decreased imports of some primary products.

This requires sustained effort over a period of years and the fulfillment of three basic prerequisites:

- monetary stabilisation
- restoration of intra-European trade
- expansion in European production

which are studied in Part IV of the report.

#### PART IV

##### PROBLEMS OF EUROPEAN RECONSTRUCTION

###### 1) The Problem of Inflation

The report contains a review of the causes and of the economic evils of an open or suppressed inflation. The main causes of inflationary pressure are: 1) excessive public expenditure in relation to revenue, 2) a reduced propensity to save by the public, as a result of the reduction of standard of living and the accumulation of wartime savings held in more or less liquid forms, 3) high investment requirements for urgent reconstruction, 4) in countries where inflation has advanced far enough, a tendency to hoard real values. The basic condition of monetary stability is reasserted: capital expenditure (government expenditure, private capital outlay and additions to stocks) must not exceed available savings.

### Budgetary Situation

The budgetary situation of thirteen countries is reviewed in terms of comparable percentages of expenditures, revenues and deficits in 1946, 1947 and 1948 as against 1937 or 1938. In most countries expenditures in real terms were considerably above pre-war, e.g. by 300% in the Netherlands and 200% in U.K., Sweden and Denmark. On the other hand, in countries with acute price inflation (France, Italy, Poland, Greece), the real volume of government expenditure was low. Public revenue rose, but at comparatively much smaller rates than expenditure so that deficits were incurred, in many cases as heavy as to represent 40 to 60% of total pre-war expenditure. (The only exceptions appear to be Denmark, Sweden, and (in 1947) the United Kingdom). In 1947, the situation of public finances generally improved over 1946. A notable fact is that the real volume of tax revenue has been generally well maintained (a difference with World War I).

### Open and Repressed Inflation

Where price controls and rationing are enforced, they lead to a relative scarcity of goods, in comparison with the levels of incomes and credits. The reverse is true in countries with open inflation. The index of real value of cash holdings (i.e. index of currency circulation, index of retail prices) shows the difference in the level of liquidities in both situations: high in e.g. U.K., low in France <sup>1/</sup>. Consequences of open or repressed inflation are very different, and sometimes drastically opposed. Open inflation leads to unjust income distribution (between wages and profits,

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<sup>1/</sup> A high level of liquidities is, of course, not in itself an indication of a state of repressed inflation. It can also be a consequence of a rise in real incomes, e.g. in Portugal.

town and country, etc.). On the other hand, repressed inflation reduces the incentive to work and produce. (while both types of inflation may stimulate production of unnecessary luxuries at the expense of essentials). The most spectacular distortions may be partially corrected by subsidies, but these tend to perpetuate the budgetary causes of inflation. The establishment of double markets is also a dangerous remedy, as the uncontrolled market tends to eliminate the controlled one, with an eventual open inflation. It is difficult to say which, open or repressed inflation, has the lesser evil effect on production. The situation in Germany is characterized by the disparition of money in most of its social functions. It is necessary to rebuild an entirely new system of wage and price relation.

#### Inflation and Foreign Trade

The well-known effects of inflation on foreign trade are described. In both their open or repressed forms imports are encouraged and exports discouraged. In the one case, high internal prices are reflected abroad through an over-valued currency. In the other, excess demand in the home market creates a pressure to augment imports and to absorb potentially exportable surpluses. In addition, exports of countries with open inflation and over-valued currency tend to be diverted from hard currency areas towards regions with similarly over-valued currencies. There is no satisfactory method of measuring the degree of over-valuation of particular currencies. It is too early yet to judge the effects of devaluation and of the limited "free" foreign exchange markets on the exports and terms of trade of the countries concerned.

#### 2) The Problem of Intra-European Trade

The fact that intra-European trade is lagging seriously behind European recovery in general has already been mentioned <sup>1/</sup>. Germany played

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<sup>1/</sup> The qualifying statement in page 8, note 2, about the extent of recovery in Western Europe should be kept in mind here.

a major part in this trade, the decline of which is one of the chief reasons for Europe's extraordinary post-war requirements from overseas. Restoration of intra-European trade is thus a prerequisite for the cure of the acute external disequilibrium.

The pre-war pattern is analyzed (though admittedly not as a model for the future). The picture was complex. There was 1) an exchange of both manufactured and primary goods by industrial countries among themselves. 2) An exchange of manufactured goods for raw material and foodstuffs, between industrialized and less industrialized countries. Bread grains moved from Eastern to Western Europe (providing 20% of total European imports of bread grains). 22% of total U.K. requirements in foodstuffs for 1938 came from Europe (about \$975 million). 3) Europe was its own source of supply for three major raw materials and semi-manufactures: coal, steel, and timber. 4) Manufactured goods played a greater part in intra-European trade than either foodstuffs or raw materials; Germany was Europe's main supplier in this field.

Trade settlements were based primarily on two major factors which have now disappeared: 1) A large import surplus into the U.K.; 2) a large export surplus from Germany. Thus, European countries could buy from Germany with the proceeds of their sales to U.K., the latter financing its purchases from its large invisible earnings. Germany in turn could maintain a large import surplus of raw materials from overseas.

The pattern of post-war trade is very different. There are some elements of strength and many weaknesses. Trade in foodstuffs has diminished sharply, as well as trade in raw materials and semi-manufactures, creating inter-related and cumulative shortages.

On the other hand, if Germany is excluded, 1947 exports of heavy industrial products within Europe were in real terms only 6% smaller than in 1937, which is an achievement on the part of individual European industrial

countries. But total 1947 intra-trade, including Germany, is only 56% of 1937 and this shows the magnitude of the gap left by Germany and the size of the effort still to be made if European trade is to regain its pre-war volume. In individual items of physical production, the picture is still worse: total iron and steel supplies of European countries are only about one-half of the 1937 volume <sup>1/</sup>. And the present recovery, largely accounted for by exports of vehicles, is less significant than would be a recovery in iron, steel, and basic machinery. Disappearance of German exports has been particularly severe on Central and Eastern European economies (the total amount of heavy products available to them in 1947 from industrial countries in Europe was only 25% of 1937). Another element of weakness in Europe's post-war trade is the emphasis on luxury and non-essential goods stimulated by inflation and often forced through the agreements by "tied" sales <sup>2/</sup>. The extent of true recovery of trade may also be somewhat exaggerated, because of the growing tendency to export only highly finished products, which results in increasing trade values without a corresponding increase in utility.

The post-war system of trade settlements in Europe is the network of about 200 bilateral trade and payment agreements. The basic cause for soft currencies and the system of bilateral agreements to which they have given rise is the fundamental disequilibrium in the balances of payments of all European countries. Due to the lack of equilibrium in the balance of payments of individual European countries with other European countries, and to the exhaustion of credit facilities, previous attempts towards greater multilateralism have failed <sup>3/</sup>. The recent multilateral compensation agree-

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<sup>1/</sup> They are 75% if Germany is excluded. But the elimination of Germany from trade statistics does not increase available supplies.

<sup>2/</sup> As an example, 1947 imports of luxuries in Sweden are, in volume, at between 120% (perfumes) and 1300% (furs) of pre-war.

<sup>3/</sup> e.g. U.K. transferable accounts system.

ment of November 1947 cannot be very promising either, unless some change occurs allowing for: 1) approximate equilibrium in the position of each individual member against all others, and 2) acceptance of the fact that bilateral disequilibria may arise between members. Actually, strict bilateralism is still growing.

This process, though indispensable in view of the present situation of European trade <sup>1/</sup>, has serious drawbacks. Goods cannot be bought, or sold, in such places or in such quantities as would bring the maximum advantage. The most urgent import needs may have to go unsatisfied, if the principal supplying country is unwilling to accept the only available offsetting exports. These weaknesses may be concealed by the mere fact that the volume of trade increases. But commodity composition and geographic distribution may be as important as volume.

Of course, these disadvantages do not exist when, though trade is conducted under bilateral agreements, there is no need for a close bilateral balancing of accounts. It is in this direction that the solution of the problem lies. Arrangements for permitting freer convertibility of European currencies are only a symptomatic cure. They could possibly worsen the general situation as the fundamental lack of balance in trade would remain unaffected (by failure to eliminate its essential causes: inflation, low production), while new distorting and restrictive factors would appear as a result of increased competition for spendable balances in the common monetary units (competitive exports, general import restrictions). Only under conditions which permit equalization of supply and demand for individual currencies can convertibility be restored. In so far as internal inflation is not the cause of the disequilibrium, only international measures can help, either credits by the exporting countries <sup>2/</sup>, or a cooperative approach to

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<sup>1/</sup> Where a few countries have a deficit against most others without adequate offsetting surplus.

<sup>2/</sup> Either in the form of unilateral credits or of long-term bilateral agreements.

the problem of adjustments in trade <sup>1/</sup>, or the setting up of a system of triangular settlements. It must be recognized that the report does not strike a very **hopeful** note in this connection, and does not offer any alternative to the closing of the dollar gap existing in each individual country.

### THE PROBLEMS OF PRODUCTION

#### 1) Dimensions of the Problem

In order to fill the gap in European balance of payments with overseas, an increase of \$2,000 million (of 1938 dollars) in the production of heavy industries has been estimated necessary, while to compensate the loss of Germany as a supplier of iron and steel in inter-European trade an increase of \$400 million is required. These two items together necessitate an increase of production of 20 to 25% above 1938. In addition, in view of the fact that 1938 was relatively a depression year, and that added capacity in heavy industries means higher requirements of steel, etc., another 20-25% increase in heavy industrial production is needed. Thus, the total increase in production required in the three heavy industries (iron and steel, engineering and chemicals) should be around 40-50%.

#### 2) The Reconstruction Targets

Production targets <sup>2/</sup> for 1951 are amply sufficient for steel (60% above 1938). This should also prove sufficient for the necessary expansion of engineering industries and electric power production. The coal target - 17% above 1938 - appears small in comparison but might more than satisfy total requirements in view of the decrease in coal consumption per ton of steel. In agriculture, targets of exporting and importing European countries taken

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<sup>1/</sup> Allowing for the least collectively damageable form of adjustment, e.g. expansion of essential U.K. exports to Europe versus curtailment of U.K. imports from Europe.

<sup>2/</sup> CEEC targets excluding Germany. Including Germany overall increases are 16% in steel, 10% in coal.

together are 100% of pre-war in grain and potatoes, 115% in sugar, but only 90% in milk and 87% in meat. In view of the 5% to 6% higher European population to be expected by 1950, this means lower standards of food supply and at the same time import requirements higher than pre-war (an increase of 33% in import volume would be necessary merely to maintain total supplies at pre-war levels, without any allowance for increased population nor for failure of recovery in inter-European trade). In manufactures, even with existing targets, the 1952 level of imports will still be 500% of pre-war for manufactured equipment, or of 273% of pre-war for iron, steel and manufactured goods taken together. It is thus clear that balance of payments equilibrium could not be realized in 1951-52, and that to realize it in later years such imports of manufactures would have to be severely cut.

Realisation of targets will depend on three factors: 1) receipt of continued financial assistance, 2) adequate credit arrangements between European countries for the best use of existing capacity, 3) harmonization of rates of expansion in various sectors to avoid bottlenecks.

### 3) Bottlenecks

The transport bottlenecks is overcome. So is the coal bottleneck, due mainly to the U.K. and Polish production and to imports from U.S. Electric power and steel are now appearing in short supply, as well as installed capacity in various fields <sup>1/</sup>. In addition, artificial bottlenecks are created in many instances by lack of credits to move raw materials towards installed capacity. Timber is bound to be scarce for a number of years, but the incidence of the shortage is very unequal in different countries.

On the whole, however, as the main bottlenecks move from the raw material stage to the later manufacturing stages, they should become easier to overcome. The manpower problem should be eased by international migration.

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<sup>1/</sup> Wagon and locomotive repairs in particular.

But it is mainly necessary to increase productivity. The prospects of obtaining production targets are not unpromising, if the three prerequisites mentioned above are fulfilled, namely: 1) continued financial assistance, 2) adequate inter-European credit arrangements, and 3) harmonization of rates of expansion in the various sectors of production.

Achievement of these targets may not be sufficient, however, to restore at the same time complete balance of payments equilibrium and the pre-war standard of living.

APPENDIX A

THE ECONOMIC PLANS OF EUROPEAN COUNTRIES

Economic planning is more and more developed in most countries in Europe, at least for the direction of capital investments. Most plans will end by the beginning of the next decade, so that it is possible to obtain a picture of the main changes in production to be expected by then. Success of the plan is almost exclusively a matter of internal effort in the case of the U.S.S.R. For the countries in the CEEC, it depends explicitly upon the continuance of U.S. assistance. In most countries, the success will depend on mutual consistency of the plans, and on some foreign help.

PLANS IN CENTRAL AND SOUTHEASTERN EUROPE

These plans are designed mainly to accelerate recovery to pre-war levels (Czechoslovakia, Bulgaria, Hungary) or to create industrial expansion in agrarian countries (Yugoslavia). In addition, they seek to solve special problems: incorporation of new territories (Poland), elimination of section of differences in living standards (Czechoslovakia), reorganization of agricultural production after a land reform (Hungary).

The expected rate of increase of industrial production is, in most cases, much higher than that of agricultural production, where only Yugoslavia and Bulgaria expect to exceed their pre-war output (by 152% and 134% respectively) General indexes of industrial production to be reached at the end of the plan are: in Poland 152%, in Czechoslovakia 110%, in Hungary 127%, in Yugoslavia 323%, in Bulgaria 134%.<sup>1/</sup> Rates of investment under these plans often attain 20% of the national income. Despite this, considerable increases in consumption are expected by the end of the plan (51% per capita increase in Poland, 3% absolute increase).

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<sup>1/</sup> Bases: 1938 = 100 for Poland and Hungary, 1937 = 100 for Czechoslovakia and Bulgaria, 1939 = 100 for Yugoslavia.

One of the main problems of the plans is to absorb surplus labour and improve occupational distribution. In Poland, for instance, total employment is expected to rise by 400,000 in three years, while urban population will increase by 800,000 (total working population - 12.8 millions). Czechoslovakia is the only country where labor shortages are likely to occur, but mobilisation of labour and migration schemes are prepared. Individual aspects of the plan are reviewed in the report. The most far-reaching changes are in electricity, where total production <sup>1/</sup> at the end of the plan will be about 240% of 1937. Total coal and lignite production <sup>1/</sup> will be 134% of 1937. Finished steel production will be 112%. (Later plans to come in force after the current plans foresee larger increases.) Petroleum production will be 165% of pre-war. Big increases of output in non-ferrous metals are foreseen, particularly in Yugoslavia.

None of the plans are intended to be achieved on a basis of self-sufficiency. But large changes in the pattern of trade are to be expected. The share of the Soviet Union's trade is increasing in the total trade of Southeastern European countries, taking to some extent the place of Germany, at least in volume, but not in substance. Instead of raw materials and foodstuffs, the U.S.S.R. needs industrial goods, so that new trade relations tend to assist industrialization, while trade with Germany tended to retard it. Though trade with Western Europe is still very important (specially in Czechoslovakia and Poland) and not bound to diminish, the future of food exports at least is uncertain.

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<sup>1/</sup> For Poland, Czechoslovakia, Hungary, Yugoslavia, Bulgaria.

THE FOURTH FIVE-YEAR PLAN OF THE U.S.S.R.

Between 1928 and 1941, industrial production has increased 6.5 times, and the whole national output by more than five times. During the war, over 1,300 large industrial plants were transferred to the East and were working at full capacity by the first half of 1942. This is only one example of the immense increase of production in the East where, for instance, arable land was increased by 12 million hectares, that is, more than the annual peacetime growth in sown area for the whole of the U.S.S.R. But in the West war destructions did more than offset this increase. About 40 to 60% of total pre-war production in key industries was seriously damaged. By 1945, about 30% of industry in the liberated areas was restored. Percentages (the only figures available for output) point to a substantial increase in production in the last two years. By October 1947, the gross output of "large scale industry" was stated to have regained the average monthly output of 1940. Levels of consumption have been improved (end of rationing, abolition of the multiple price systems).

The Fourth Five-Year Plan aims at the rehabilitation of war devastated regions and at the continuation of the major task of industrialization. The general increase over the period is 48% <sup>1/</sup> for industrial and 27% for agricultural production. The heavy emphasis placed on expansion of engineering is the most notable feature of the plan; by 1950 the total stock of metal working machine tools is to be 1.3 million - larger than the pre-war stock of the United States. This emphasis on engineering shows that an intermediate stage of industrialization has been reached, when the base of heavy industry being more or less secured, its engineering superstructures have the fastest

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<sup>1/</sup> This relatively low percentage reflects the effects of war. Increase over the First Five-Year Plan was 147%, over the Second 120% and over the Third 88%. Of course, there was also a natural decrease in percentage growth, as industrialization progressed.

rate of development, allowing for easier output of finished products. Agriculture plays also an important part, which may be gauged by the fact that between 1946 and 1950 the farmers are to receive 720,000 tractors, and 17 million tons of mineral fertilizers. There is also an expensive program of electrification. Increase in cereal output over 1940 is modest, it is much more substantial in industrial crops. Increase in transport is to allow for a 28% increase over 1940 in actual freight carried.

No indications are given in the plan on the future of foreign trade. However, the latest trade agreements of the U.S.S.R. show that the latter intends to resume the importation of manufactured equipment in return for grain and industrial raw materials.

#### THE ECONOMIC PLANS OF THE CEEC COUNTRIES

A detailed description is given of the problems and plans of the CEEC countries. In view of the relatively well-known character of these questions, only the most significant observations will be summarized here.

The coal production plan of the CEEC is criticized because 1) it does not allow for any margin in cases of unforeseen emergencies, 2) it still relies (though modestly) on coal imports from the U.S. at the end of the period, and 3) it presumes a considerable change over from coal to oil, resulting in increased dollar expenditure.

Steel. The plans provide for much larger imports of crude steel, and larger exports of finished steel than before the war: net imports of crude steel are to be 2.7 million tons in 1951 while they were negligible before the war, and net exports of finished steel are to be about 4-1/2 million tons as against only 0.6 million in 1938. These larger imports of crude steel are a vulnerable point in the plans, as U.S. exports of crude steel are likely to be only one-fifth of the CEEC estimate (finished steel will be exported by the U.S.,

in compensation). U.S. State Department estimates assume only, in 1951, a 68% increase over 1938 production of the 16 countries (CEEC 86%) and net exports at 2.7 million tons (CEEC 4.5 million).

Agriculture. CEEC estimates of import requirements are in some cases (notably cereals and meat) higher than the supplies likely to be available.

The economic justification of the steep increase planned in mechanization, questioned by the Harriman Committee, is upheld by the report. It will, in particular, offset the loss of draught animals, and release land from fodder crop towards human food production. The deficit in fertilizers should be offset over the period, though in the first two years, there will be a deficit. The conflict between alleviation of the European timber shortage and the sales of pulp in hard currency areas is noted.

Balance of payments.

1) The CEEC plans provide for the restoration of the pre-war relation between overseas imports and exports, but does not realize such adjustments in the trade balance as are required to offset the loss in invisible incomes described in the report.

2) The trade deficit with the U.S. will still be much larger than pre-war.

3) For some countries, the trade deficits with particular areas are expected to be very much larger than the overall deficit, so that multilateral settlements on a large scale may be necessary. But the CEEC is more an investment plan than a plan aimed at restoring a rigorous equilibrium.

APPENDIX B

NOTES ON SOURCES AND METHODS

Only one important item in this appendix is reviewed here.

Index numbers of industrial production

A special index number has been compiled for the U.K. (where no official index is published). The original base is 1935 = 100. It is constructed from individual indexes of production in the "Monthly Digest of Statistics" weighted according to the net values of output as given by the "Fifth Census of Production" (1935). The base has then been shifted to 1938, using the pre-war Index Numbers of the Board of Trade, the composition of which has been followed as closely as possible in selecting the elements of the new index.

The weights used and the results of the calculations are shown in the following table.

THE LEVEL OF INDUSTRIAL PRODUCTION IN THE UNITED KINGDOM

Index Numbers 1938 = 100

Groups	Relative weights	1946				1947		
		First quarter	Second quarter	Third quarter	Fourth quarter	First quarter	Second quarter	Third quarter
I. Mines and quarries	12	83,3	84,4	79,5	87,7	86,6	86,9	80,4
II. Iron and steel	10	113,4	115,3	109,5	120,1	101,5	116,0	111,0
III. Non-ferrous metals	2	116,3	122,0	106,8	115,0	103,3	109,7	103,6
IV. Engineering and shipbuilding	21	85,7	98,3	95,2	118,6	101,9	120,1	123,6
V. Building materials and building	7	54,8	65,8	74,2	78,2	54,8	78,3	86,1 <sup>a/</sup>
VI. Textiles	13	80,2	82,5	85,1	90,3	78,1	90,2	91,1
VII. Chemicals, oils, etc.	7	139,5	149,5	146,2	157,9	137,6	153,4	145,7
VIII. Leather and boots and shoes	3	99,0	99,7	100,8	108,8	96,0	115,5	114,3
IX. Food, drink and tobacco	17	109,9	103,7	104,3	117,2	104,7	106,4	105,4
X. Gas and electricity	8	170,0	137,2	130,9	175,4	184,8	140,8	131,6
Total of all groups	100	100,9	102,1	100,3	115,2	103,1	110,2	108,7

Source: Research and Planning Division, Economic Commission for Europe.

<sup>a/</sup> Estimated by the change in consumption of cement and bricks between the second and third quarters of 1947.