

10th July 1947.

BASLE

C.B. 199

THE MARSHALL PROPOSAL  
OF ASSISTANCE TO EUROPE

The need of additional measures, of an exceptional and transitory character, in favour of Europe.

I. In his speech of 5th June 1947, Secretary of State Marshall said that "before the United States Government can proceed much further in its efforts to alleviate the situation and help start the European world on its way to recovery, there must be some agreement among the countries of Europe as to the requirements of the situation and the part these countries of Europe themselves will take in order to give proper effect to whatever action might be undertaken by this Government". The rôle of the United States would consist of friendly aid in the drafting of a European programme and of later support of such a programme so far as it may be practical for the United States to do so.

At the time when hostilities ceased, the following programme of humanitarian aid and new foreign lending was already in force or envisaged in support of countries in need:

Firstly, various forms of humanitarian assistance for war-stricken countries, supplies being provided primarily by the military governments and UNRRA but also by the Red Cross and by a few countries individually. The total aid was probably the equivalent of around \$5,000 million, the benefits as far as Europe was concerned being, in fact, reserved for the centre and the eastern part of the continent, none going to the peoples on the Atlantic seaboard.\* The British Empire as a whole contributed about one-quarter of the funds, while the United States furnished about 72 per cent.

Secondly, a series of governmental long and short-term loans and credits designed to cope with some pronounced post-war difficulties, amounting in the aggregate to about \$12,500 million (authorized) up to the end of 1946. Of this total, over \$500

---

\* While France, Holland, Belgium, Denmark and Norway made no contributions to UNRRA's operating funds, they declared that they did not expect any benefits for themselves from such funds.

- 2 -

million was granted by means of payment agreements between European countries; \$3,200 million was for settlement of lend-lease pipeline goods and the disposal of U.S. surplus property; the largest items were the two loans to Great Britain of \$3,750 million from the United States and Can.\$1,250 million from Canada. These various loans and credits were regarded as a preliminary for the doing of useful work by the Bretton Woods institutions with, later on, a revival of private lending, it being found, in particular, that a reconstruction of the world's "key currencies" was one of the first steps on the road to recovery.\*

Thirdly, long-term loans for reconstruction purposes to be arranged through the International Bank for Reconstruction and Development. In April 1947 the dollar funds held by this Bank amounted to \$727 million, from which in May a loan of \$250 million was granted to France; in July debentures to a total of \$250 million are to be issued by the Bank, on the U.S. market. This total is to be made up of \$100 million 2½% 10-year bonds and \$150 million 3% 25-year bonds.

Finally, the maintenance of a stable monetary system to be assisted by the International Monetary Fund, the aim of which would not be to grant reconstruction credits but progressively to abolish monetary restrictions, at least for current transactions.

Mr Marshall pointed out that "the rehabilitation of the economic structure of Europe quite evidently will require a much longer time and greater effort than had been foreseen". The task confronting the European countries is thus to agree upon a joint programme setting out the measures which they themselves can and should take and the assistance required from abroad to secure a return of their "normal economic health". In other words, it might be said that the preliminary stage, before more permanent methods of financing will suffice, has not yet been concluded, extraordinary measures being still required. On the other hand, it is obvious that the extraordinary assistance which the United States may agree to extend to Europe will not be unlimited as to time and must, moreover, be clearly defined as to its purpose. It is, in other words, essential that the efforts which the European countries themselves will make as well as the

---

\* Another item of financing (not included in the above figure of \$12,500 million) has been the rather unexpected cost of together more than \$1,500 million a year falling on Great Britain and the United States as occupying powers of Germany, Japan and other countries (part of the cost being for the relief of the local population).

assistance which will be granted by the United States should be so planned and adapted as to produce the most decisive results with as little delay and as moderate cost as possible.

Measures to overcome exceptional shortages of particular commodities.

II. One approach to the problem is to calculate the exceptional needs of Europe in terms of particular commodities, such as food, fuel, manures, machinery, etc., and in that connection to indicate:

- (i) the practical measures which can be taken by the European countries with a view to increasing, as promptly as possible, the output of products in short supply; and
- (ii) the additional quantities which the United States may be in a position to furnish for certain specific periods and on terms which will have to be laid down.

The approach to the problem in terms of particular commodities would seem to have been the manner primarily envisaged by the British and French Governments. In their note of invitation, they proposed the formation of various sub-committees to the Committee of Co-operation, which will deal with this so important aspect of the problem.

The present memorandum is not intended to enter into the different questions to which the work thus set on foot will give rise, but it wants to draw attention to some other aspects and, in particular, to make some observations referring to that part of the note of invitation in which it is stated that "examination of the balance of payments problems shall be undertaken by the Committee of Co-operation itself".

General cause of monetary dislocation.

III. It is, indeed, impossible to separate questions of shortages in terms of commodities (food, fuel, etc.) from the financial and monetary aspects, one reason being that the shortages lead to heavy imports and insufficient exports and thus to a disequilibrium in the balance of payments, which in its turn reduces the holdings of foreign currencies, notably of dollars.

In some respects, however, the exceptional shortage of a few essential commodities may be of decisive importance independently of the monetary situation. Thus, a deficiency in the coal supply and in

n  
up,  
ith  
nt  
.

the supply of some indispensable foodstuffs may well arrest a possible increase in production (because of the lack of energy) or lead to a disastrous state of nutrition, and that would be the case even if there were no budgetary difficulties or lack of foreign exchange. In some countries (as, for instance, France and Italy) the rate of increase in production has for some time been considerably slowed down by the impossibility of obtaining sufficient imports of coal. In fact, one of the most efficacious means of improving the financial and monetary situation is then clearly to find a solution of this particular supply problem.

But this is not the whole story: as a rule, a part of the shortages of goods and services, and the consequent shortage of dollars, from which so many European countries are suffering must clearly be regarded as a direct result of the financial and monetary instability which the countries in question have not yet been able to overcome.

Mr Marshall himself emphasised strongly in his statement at Harvard that the physical destruction in Europe, great as it was, is "probably less serious than the dislocation of the entire fabric of European economy", and in this dislocation financial and monetary disorder plays an essential part. As Mr Marshall went on to observe, confidence in the local currency has been severely shaken in many European countries. The peasant is little inclined to sell his farm produce for money with which he cannot purchase the goods he needs. The normal division of labour between the towns and the countryside has broken down and the towns must often be supplied by imports which are out of proportion to the available foreign resources.

No investigation of the problem of shortages will proceed far before it is found that the extent to which supplies can be made available within Europe itself will largely depend on the progress in attaining monetary stability. It is, indeed, essential that, in the words of Mr Marshall, "the manufacturer and the farmer throughout wide areas must be able and willing to exchange their products for currencies, the continuing value of which is not open to question".

The problem to be solved is thus not simply one of making up, by means of deliveries in kind from abroad, the serious shortages with which the authorities are faced, for it cannot be left out of account that the shortages are greatly accentuated by the existing state of monetary insecurity. As always, monetary insecurity puts a brake on the volume of produce coming on to the market, encourages

parasitical activities and wasteful consumption and, moreover, makes it impossible to attain the best distribution of labour and other resources or to secure either a sufficient volume or a constructive use of current savings. Such monetary insecurity thus militates against an increase in production, on which Europe's welfare depends, both directly and indirectly, through the exchange of goods and services with other continents.

The effect exerted on the balance of payments by the inflationary tendencies prevalent in many European countries.

IV. The financial and monetary insecurity still so characteristic of conditions in many European countries is essentially the result of remaining inflationary tendencies. These tendencies are often quite plainly the sign of a serious disequilibrium in the public finances but there are sometimes less obvious, but equally important, instances where the disequilibrium relates not specifically to the budget but to the

whole economy in that the national income in real terms, i.e. the total output of goods and services, does not suffice for the aggregate needs of current consumption, military and social charges, peacetime reconstruction and other investments. The result is then an excessive resort to the banking system with an artificial expansion of money incomes unmatched by any corresponding increase in the supplies of consumers' goods and with a consequent tendency to a rise in prices, which can, as a rule, be only imperfectly combated by a series of administrative measures, such as control and rationing. Experience shows that a disequilibrium in the national economy, if it is not kept within very narrow limits and especially if it is allowed to continue for a considerable time, has disastrous consequences for the supply position and the balance of payments. In a number of different ways, continued inflation leads directly and indirectly to an exhaustion of foreign reserves:

1. It is common knowledge that in several countries of Europe "hidden stocks" exist of foodstuffs and of manufactured articles. These stocks may not be large if taken individually but they would make a considerable addition if they could be brought to the markets. Experience shows, however, that very little effect may be expected from confiscations or other mandatory measures and that it is of no use to blame the manufacturers or the farmers as long as the money given in payment does not command confidence. There are cases on record when wheat was shipped to European countries although farmers in these countries were suspected of

- 6 -

having fairly large supplies, which, however, were inaccessible. Whenever the people in general are short of food and fuel, "the governments are forced to use their foreign money and credits to procure these necessities abroad" - a process which, of course, exhausts funds urgently needed for reconstruction.

2. An inflationary expansion of purchasing power at home (whether resulting from current budget deficits, too large a volume of public or private investments, or sudden sharp increases in wages and salaries unmatched by sufficient goods) acts as an attraction for imports and a brake on exports, the inevitable result being a continuous deterioration in the balance of payments. With the maintenance of fixed exchange rates - as has been the rule after the second world war - the inflationary expansion, moreover, tends to make the home currency overvalued and this in itself, as experience shows, is a most potent cause of excess imports and also of a flight of capital, which is unlikely to be wholly arrested by even the strictest control.

3. A distrust in the currency intensified by dwindling monetary reserves is then almost always accompanied by widespread hoarding of gold and foreign exchange and, generally, a disinclination to hold the national currency in any form and least of all as savings deposits.

4. The distrust naturally spreads abroad, with the result that no support worth mentioning will be obtained from foreign commercial credits or direct foreign investments.

5. The process of rapidly using up monetary reserves of gold and "hard currencies" cannot for long be offset by new foreign loans and credits for the simple reason that the exhaustion of reserves impairs the credit position of the would-be borrower. Governments are then driven to cut down imports and to stimulate exports. But measures of such a kind can only be regarded as temporary expedients, since they have the effect of aggravating instead of relieving existing scarcities. Indeed, they tend to widen the gap between a redundant amount of purchasing power and an insufficient supply of consumers' goods and may even make it harder to regain a balanced position.

It is only fair to say that the intimate relation between the methods of internal financing and the outcome of the balance of payments is being more and more understood. One European country after another

has found that while even mild inflation continues, the shortage of dollars resulting from the present exceptional needs of food, coal and other materials is being artificially increased by the persistence of financial deficits, with the consequent monetary instability. When, on the other hand, a country has been able to restore monetary stability and in that way also its credit position, there has been in several instances in the past a cumulative improvement, with the reappearance of previously hidden commodities on the market, a return of hoarded gold and exchange, an influx of foreign commercial credits, as well as a resumption of direct investments by foreign firms and, as reconstruction gathers momentum, an increased flow of internal savings available for constructive use. While foreign assistance is generally needed to bring about a reversal of the inflationary tendency, the reconstitution of monetary reserves, once confidence has begun to be restored, may thus be helped by a diversity of relatively small though numerous transactions. Since it is important that the aid obtained should be used in the most efficacious manner, a financial reconstruction designed to restore confidence in the currency is an indispensable step in order to enable the European countries to derive the greatest possible use from their own resources and thus to keep their dollar requirements within reasonable limits.

Comprehensive programmes for financial and monetary reconstruction.

V. One of the most urgent tasks is thus to work out (if need be with the help of independent experts) in each country where the inflationary tendencies persist a comprehensive programme for financial and monetary reconstruction containing the following main features (well known from the stabilisation efforts after the first world war and again of importance at the present time):

1. The most important task is to establish sufficient budgetary equilibrium to exclude the necessity for direct and continuous resort by the Treasuries to central banks, as cover for either ordinary and extraordinary expenditure or deficits arising from public services and nationalised industries.

Since what is spent by public bodies reduces the resources available for other purposes, the level at which the budget is balanced is also of importance and, therefore, the opportunity afforded by reconstruction should be used for a renewed and searching scrutiny of all forms of government outlay (military expenditure being a heavy item as long as no real peace has been restored). In the stabilisation programme a part of the foreign

- 8 -

resources may be appropriated for the express purpose of covering a budget deficit until the measures by which budgetary balance may be achieved become effective so that recourse to the central bank for meeting government expenditure may be stopped for good and all.

2. Outlay for investment (either by the government itself or through private channels) should be kept within the limits of domestic savings plus the amounts obtained for investments from the foreign assistance. For the time being, even very useful outlay may have to be postponed but this must be done in realisation of the fact that budgetary balance is the best means to bring about a reversal of the pernicious tendencies which impede reconstruction. It is, indeed, futile to try to restore orderly markets or to achieve industrial progress by a plan for investments without having secured monetary stability, for the monetary unrest is likely to defeat every constructive effort.

3. Besides deficit financing and an overdose of public and private investment, an increase in money wages, unwarranted by increased supplies of goods and services, may be an additional cause of inflation and, indeed, a cause which it is difficult to master while exceptional shortages remain. In so far as the different countries will be able to obtain fresh imports in application of the Marshall proposals, an opportunity may be provided to break the vicious spiral of rising wages and prices without anybody benefiting.

4. A cleaning-up of the position of central banks, including a strengthening of their monetary reserves. This involves, inter alia, that

- (i) some repayment be made whenever a central bank is in possession of very large holdings of government bonds or has other important claims on the government (e.g. arising from enforced payments to Germany during the war);
- (ii) an amount of gold or foreign exchange should be set aside out of the foreign assistance for the purpose of strengthening monetary reserves - this to be done without the creation of a corresponding amount of purchasing power, i.e. without the government account at the bank being credited. The central bank may suitably receive the resources in question as part repayment of its earlier advances to the government or other claims (see (i) above).

Other commercial and financial measures.

VI. If inflation is arrested, there should be a less acute current strain in the balances of payments. Foreign assistance would then be used essentially for capital investment as a supplement to domestic savings. There are, however, other difficulties affecting the balances of payments, which must not be overlooked:

(i) The flow of goods may be impeded by insurmountable obstacles to trade. These problems are being dealt with by the I.T.O., but it is possible that specific regional arrangements applicable to certain parts of Europe may establish definite areas of "freer trade". This cannot, however, be a short-run development; and then it is well not to forget that today the most formidable hindrances to normal trade are found in the foreign exchange regulations and the dwindling monetary reserves, necessitating a cut in imports - hindrances which should be partially, if not wholly, removed by the application of the Marshall programme.

(ii) Extensive foreign liabilities, directly or indirectly a result of the war and thus of an unproductive character, may constitute too heavy a burden in the balance of payments of some countries. In its seventeenth Annual Report, the B.I.S. said that "the commitments represented by accumulated sterling balances, taken together with other outstanding liabilities of an official character resulting from the war and its immediate aftermath, attain a total as high as that which proved so intractable after the first world war". In agreements concluded between Great Britain and individual countries, the final settlement of sterling liabilities has been postponed to a later date, while arrangements are made for releases of certain specified amounts.

Adjustment of prices and exchange rates.

VII. The balance of payments is, however, affected by some other problems, the solution of which cannot well be similarly postponed, the most important being the establishment of realistic rates of exchange among the different European countries. Experience has shown that, when a country's rates of exchange are widely out of line with the relative purchasing power, the flow of goods is impeded, with a reduction especially of exports and a growing disequilibrium in the balance of payments, while the general structure of

costs and prices is badly distorted and often no longer capable of serving as a guide to production. The effects of an overvalued currency make themselves felt also in other countries, since the products of these other countries will seem very cheap indeed for the inhabitants of the country with the overvalued currency as long as these inhabitants are able to obtain foreign exchange at the artificial rate. The products of the other countries will thus be exposed to a strong demand, which will tend to raise their prices, until one day no more foreign exchange will be allowed for such purchases, and the trade in question may virtually come to a sudden stop, which again is undesirable.

It is, of course, difficult to tell what the true rates are before production has risen and prices have become more stabilised and, for that reason, it is sometimes thought more appropriate to postpone an adjustment of exchange rates until the situation has become more clear in these respects. If that line were adopted, any monetary reform at the time when foreign assistance is first received might lack finality and thus leave a state of doubt and uncertainty still prevailing. But the unfortunate result might then be that the curative forces in the form of a return of hoarded gold and foreign currencies, etc., would hardly be working and in that way recovery would be delayed. For these reasons it is usually advisable to make a judicious valuation and adjust the exchange rates at once in order to avoid a situation where, some six or twelve months after the reform, the authorities have to come back and disturb the public with an alteration in the rates.

Delay in one important country, moreover, deranges the rate structure of other countries. There are reasons to think that the steep post-war price rise in the United States is now over and that perhaps the stage has been set for greater stability with a gradual return to buyers' markets. This makes it more important for European countries not to retain unrealistic rates.

Finally, stress should be laid on the importance of restoring a natural balance in the cost and price structure. In more than one country relatively low ceiling prices have been fixed for necessities, while prices of luxury goods have been allowed to rise considerably, often in response to keen demand in free markets. As a result, less necessities and more luxury goods have been produced, the governments being obliged to turn increasingly to foreign supplies for meeting the barest needs in food and clothing. As these goods have to be allocated,

more controls and priorities are imposed, with often less and less chance for prices to act as a stimulus for the most wanted production.

Transferability of an increasing number of currencies.

VIII. Once inflation has been clearly arrested and a balance restored between the cost and price structures of different countries, with rates of exchange corresponding approximately to the purchasing-power parities, it should be possible to enlarge relatively quickly the field of transferable currencies, as far as current transactions are concerned, and to do that with the object in view of increasing the number of European countries with such transferable currencies and of accepting an ever greater volume of transactions as being "for current account".

Such a transferability is, of course, expressly provided for (after a maximum delay of five years) in the Articles of Agreement of the International Monetary Fund, but few European countries are in a position to fulfil the conditions of such transferability and none will be able to do so before they have put their public finances into good order. To advance the date when transferability can become possible ought to be one of the essential purposes of the application of the Marshall programme, since this would be one of the best means of relieving the dollar shortage in Europe and of limiting the assistance of the United States to what is strictly necessary.

Combination of foreign assistance with serious efforts in individual countries.

IX. The financial policy thus to be adopted should provide a basis for judging the true needs of countries and also for industrial development stretching over a number of years. Such a policy would presuppose foreign assistance but only in combination with serious efforts in the individual countries.

Financially, the foreign assistance would be used:

- (i) to cover, without inflation, the remnants of the current budget deficit during the period of rehabilitation;
- (ii) to strengthen the monetary reserves; and
- (iii) to continue necessary investments pending the development of domestic savings.

If the assistance is given in terms of goods, the financial reform may still be carried through, although then some special precautions will be needed. When goods are imported and sold on the domestic market, not only are authorities relieved from using their own reserves for the acquisition of these goods but the proceeds of the sales can be

- 12 -

used to cover a budget deficit. To obtain the full anti-inflationary effect from such imports and sales the imported goods must be sold at current market prices (and not at artificially low "political" prices, for then less currency would be withdrawn from circulation and therefore less be available for other badly needed uses as, for example, the cover of the budget deficit). Even when assistance is given in terms of goods, for reconstruction to be successful it is still necessary to draw up and put into effect a complete stabilisation programme, as outlined above. The two approaches (in terms of requirements of goods and in terms of financial reconstruction) are in no way contradictory. They have, in fact, to be combined, for only then will the assistance rendered "provide a cure rather than a mere palliative" (in Mr Marshall's words).

Naturally, the form which the assistance should take must be considered also from the viewpoint of what is most suitable to the United States, taking into account that large exports may cause a strain on the American commodity markets. In so far as the assistance is rendered in dollars or gold, it is likely that a part would be retained in monetary reserves and would, to that extent, not appear as active purchasing power on the American market but simply result in a certain redistribution of gold reserves. Up to a point, it may, thus be most economical for the assistance to take the form of grants in dollars. A successful financial stabilisation would, in any case, ensure that the help in raw materials can be limited to genuine needs by putting an end to such artificial shortages as are merely a consequence of continuing inflation.

The present dollar scarcity is enhanced by the fact that apart from the Swiss franc, there are few, if any, currencies which are readily available for payments anywhere and will, therefore, be held without hesitation. The more currencies become readily convertible and thus - to use Mr Marshall's words - become "currencies, the continuing value of which is not open to question", the easier it will be to solve the problem of the dollar scarcity without new restrictions, which would be disastrous both for the United States and for the peoples of Europe. It should clearly be attempted to reverse the policy of cutting down imports which has been forced on a number of countries by the drain on their monetary reserves. It would then be possible to realise the following main objectives of American policy:

- (i) to restore an international monetary system of sufficient stability for the most rigid controls to be removed - at least those affecting current

- 13 -

transactions (the essential purpose of the International Monetary Fund);

- (ii) to reduce barriers to foreign trade, in particular quantitative restrictions and various obnoxious forms of discrimination (one of the provisions of the lend-lease agreements and now the principal objective of the International Trade Organisation); and
- (iii) to contribute by sound loans to the reconstruction of war-stricken countries (one of the objectives of the International Bank for Reconstruction and Development).

Different stages in tackling the problems.

X. The methods of coordination applied by the European countries participating in the Marshall programme will be decided upon at the July meetings in Paris.

The first task will be to prepare a plan for action in the autumn of 1947. But only a limited number of problems will find their solution at so early a date. There are, of course, greater tasks confronting the European countries, including such questions as a freer movement of population, which may more easily be solved on a regional basis for Europe than for the world as a whole. Some of these questions may suitably be dealt with by more permanent institutions than the ad hoc bodies set up to handle the various aspects of the Marshall programme. There should thus be three stages:

- (i) the immediate elaboration of a joint programme for European inter-aid as regards specific commodities and areas, as well as the need of outside assistance;
- (ii) the elaboration and application of financial reconstruction programmes for the different countries (also with some outside assistance); and
- (iii) provision for the realisation of wider objectives of collaboration in Europe.