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NOT FOR PUBLICATION OR QUOTATION

August 25, 1949

MEMORANDUM

To: Board of Governors

From: Woodlief Thomas

Attached is a preliminary draft of the introductory section of a report on my recent trip to Europe. This section gives general impressions gathered from my observations, interviews, and discussions. Subsequent sections of the report will deal briefly with situations in individual countries.

While this section of the report contains little or no information of a confidential nature, it, of course, is not intended for publication or public quotation.

Attachment

W. T.

PROGRESS OF EUROPEAN RECOVERY

by

Woodlief Thomas

Impressions obtained from interviews in Europe  
May--July 1949

Introduction

In surveying the European economic scene, the most striking impression is one of great progress during the past year toward the attainment of economic balance, accompanied by relaxation of governmental restrictions and controls. This observation must immediately be qualified by pointing out that a satisfactorily balanced position has not yet been reached, that many restrictions must be retained, and that the road ahead is still a difficult one--exceedingly so for some countries. It must also be recognized that even the present degree of improvement would not have been possible without the aid of the European Recovery Program and that maintenance of existing conditions, not to mention further progress, is vitally dependent upon continuation of that program. The contribution made by American aid is striking, and the influence and great responsibility of American officials with respect to policies adopted and the trend of events is both impressive and awe-inspiring. The need for great wisdom and courage, as well as for caution and tact, cannot be overemphasized.

Finally, an observer is impressed both with the similarities of developments among the various countries and with the marked contrasts between them. The various European countries have many problems in common and the degree of their interdependence is striking, but at the same time each country has its own peculiar problems and the policies followed by each differ in some respects from those found elsewhere. The greatest contrasts appear in the varying degrees of restrictions and controls imposed on the economy and the extent to which the counteracting forces of the market are permitted to express themselves.

The above summary statement and also the further details of this report should not be considered as the results of a comprehensive study and appraisal of the European economies but represent impressions gained from a large number of interviews with informed people, accompanied by the hurried reading of a few reports and memoranda.

It was not possible to record accurate notes of interviews nor have available sources of statistics and other data been extensively utilized either to supplement or to check information and views obtained. To cover the subject comprehensively and precisely would require a staff of workers, study of a mass of data, and more hours of work than is available to a single individual on a hurried trip through seven countries.

### Nature of visit

The schedule of the visits was as follows:

Paris, France	May 2-20
Geneva, Switzerland	May 20-25
Milan, Italy	May 26
Rome, Italy	May 29-June 1
Zurich, Switzerland	June 8-9
Berne, Switzerland	June 10-11
Basle, Switzerland	June 11-15
Frankfurt, Germany	June 17, June 21-23
Brussels, Belgium	June 23-25
The Hague, Netherlands	June 26-27
Amsterdam, Netherlands	June 28-29
London, England	July 3-13

Persons interviewed included in each country officials of United States Embassies and ECA missions, particularly the Treasury representatives, and also central bank officials. Generally Treasury and other officials of the respective governments were also interviewed and in a number of cases commercial bankers and independent economists. Attempt was made to get points of view of others than officials. Considerable use was made of facilities generously provided by the United States Treasury representatives--including office space, secretarial assistance, and automobile transportation, as well as aid in obtaining interviews. Members of the ECA missions were also helpful. The central banks also provided or offered assistance and were most hospitable. Definite interviews were had with something more than 125 persons, not including many others who participated in group discussions. The attached list gives names and connections of most of the people interviewed. At the annual meeting of the Bank for International Settlements in Basle about 70 people were in attendance.

### Traveling conditions

It is an important item of economic information that travel in Western Europe today is satisfactory and generally very pleasant.

Hotels are efficiently operated and fairly well equipped, although in most cases advance reservations are advisable. Food is plentiful and not too expensive; only in England and Germany are there serious limitations as to food, unless one is very particular about quality of bread or coffee or feels he must have milk of assured purity. Transportation facilities seem adequate, punctual, and reasonably clean.

However, Europe cannot be considered a cheap place to travel by any means. A traveler in Europe sees evidence of overvaluation of European currencies relative to American prices. This apparent overvaluation may in part reflect higher retail prices for tourists. It is possible that buyers at wholesale could obtain goods at prices low enough to be competitive with American products. It is, nevertheless, true that travel or residence in Europe does not offer to Americans lower costs of pleasant living to the same extent as was possible in prewar periods. While servants are generally more plentiful at lower wages than in this country, they are by no means as plentiful, as satisfactory, or as cheap as they once were.

A traveler runs into some minor complications with respect to the exchange of dollars into local currencies. Currencies can be bought more cheaply in some ways than in others. They can generally be purchased more cheaply in countries other than the issuing country--particularly in Switzerland, but nearly all countries--Switzerland and Belgium being exceptions--place definite limits as to amount of currency that can be brought in or taken out. These restrictions require reporting at borders and, together with customs regulations, somewhat retard and complicate travel between countries. The rules, however, are not too rigidly enforced and no serious inconvenience is entailed.

#### General economic characteristics

General conclusions regarding various aspects of European economic conditions may be summarized as follows:

1. Inflationary pressures, which were so dominant a year ago, have generally subsided. Inflation control is no longer a major objective, but it is still a minor objective in most countries. There was during my visit little or no evidence of recession in Europe.
2. Prices generally are no longer rising. Although prices have declined a little in some countries, they are firmer than in the United States. The United States decline has been largely absorbed in the system of controls and subsidies before affecting internal prices. Direct price controls and rationing have been considerably relaxed or removed, but continue as important factors in many countries, especially in Britain.

3. Production has grown rapidly in all countries. This is an important factor reducing inflationary pressures. The growth in production is partly a reflection of favorable harvests in 1948 but is also a result of industrial recovery. In many countries output is now above prewar levels. One important question is how close over-all production is to effective capacity, i.e., how much further can production be increased. This is largely a matter of increased productivity, rather than finding markets or providing more jobs.

4. There is very little unemployment, although some increase has occurred in Italy, Belgium, and Germany in recent months. These increases are in part due to structural factors rather than to decreased demands for goods.

5. Consumption levels have been raised by substantial amounts in all countries. Distribution of consumption varies, however. In England and the Netherlands, rationing and allocations have given broad distribution among the population, whereas in France and Belgium distribution has been effected more through the price mechanism, with probably less equitable results. One of the major differences of viewpoint is which of these methods provides the most effective results in the end.

6. Internal savings and investment have increased somewhat, but are still far from adequate to provide needed expansion in productive capacity. There are constant controversies and conflicts of policy around the relative merits of directing resources toward increasing investment, maintaining or raising standards of consumption, or expanding exports. The burden of taxation and its distribution have a bearing on this problem, as do credit policies.

7. Exports have also generally increased and deficits in trade balances have been reduced. Large deficits remain, however, and Europe as a whole has an apparently insurmountable deficit with the dollar area. Balance-of-payments problems occupy the center of the stage, although production and consumption are basically more important. There is some thought that too much attention is given to the basic dollar-shortage problem. Very complex systems of import controls, bilateral agreements, and export stimuli have been brought into play in order to reduce demand for dollars and build up markets, but it is believed by many that they have created distortions from the more economical channels of trade.

8. The European Recovery Program is very probably the most important single factor in European progress toward a balanced economy-- or at least toward an appearance of balance. It provided--

Consumption goods, which permitted improvement in living standards, gave incentives to workers, and reduced inflationary pressures.

Producers goods for increasing productive capacity.

Balance in foreign exchange which reduced pressures toward currency depreciation.

An anti-inflationary absorption of buying power.

While ERP has made an essential contribution, the question whether Europe can be independently viable by 1952 is still undecided. The current British crisis raises questions about adequacy of current ERP aid, as well as about the adequacy of measures adopted by the British to balance their positions. Continuation of some sort of aid beyond 1952 may be essential. Strenuous efforts have been made by the various countries to prevent inflation and to move toward the attainment of economic balance.

9. Credit restrictions have been imposed in all countries with varying degrees of intensity and with striking differences in methods. Credit expansion has been greatly moderated, although not altogether stopped. The variety of procedures adopted offers an interesting study of monetary policies, as well as of national differences in institutions and habits.

One aspect of the contrast in credit policies is seen in the wide differences in levels of interest rates among the various countries. In a country like Belgium (one with a balanced economy) and in Italy, interest rates are high, whereas in Holland (where a balance has not yet been reached) there are low interest rates, and in England they have also been low until the recent break in the bond market. An important controversial question is whether higher interest rates have helped to bring about balance.

10. Fiscal policies have also been directed toward diminishing inflationary pressures. Although many countries still have budgetary deficits, these have been markedly reduced. While further measures toward balanced budgets and public debt retirement need generally to be encouraged and strong pressures for increasing expenditures must still be resisted, the present fiscal picture is hardly alarming.

11. Exchange rate policies, as well as import and export controls and trade agreements, have been directed toward the balance of payments problem. Exchange controls are essential under existing conditions to prevent broad-scale movements of capital seeking safer or more profitable investment. In the 1920's uncontrolled capital movements were largely responsible for the drastic depreciation of currencies and the extreme inflationary developments in many countries.

Export controls are also needed as a means of restricting capital movements, as well as directing international trade. A variety of exchange rates for different purposes is a part of this pattern--entailing in some cases inconsistent cross-rate relationships. An important problem is how to reduce these controls and still assure a balance in international accounts.

One of the most important questions in Europe today is whether the general level of exchange rates is one that gives the best results and can be maintained for some time. This question has generally not been considered as important among Europeans as it seems to be viewed in America. There are wide differences of opinion as to the timeliness of action to adjust exchange rates in the near future, with impressive arguments on both sides of the controversy.

12. European payments schemes, which are so much discussed, have been adopted as a device for encouraging intra-European trade. While the payments scheme has no doubt assisted in broadening the possible channels of trade, there remain many hindrances and in some respects the payments scheme has been used as a means of directing trade into less economical channels. The Italians claim that they have been accumulating sterling balances, which they cannot use because the British would rather sell to those who can pay with dollars or because British prices are too high. Belgium makes the same complaint. It is claimed by some that the British have used the payments scheme to help build up a sterling area with artificial limitations on the flow of trade.

13. Another problem that impresses many American observers in Europe is the tendency to suppress the operation of competitive forces. This tendency is found among both businessmen and Government officials. It is expressed in the formation of international cartels and in various measures for the fixing and maintenance of prices and the allocation of markets. Question has been raised as to whether these policies unduly diminish inducements for seeking new markets, for cost reductions, and for expanding productivity, all of which are essential for the establishment of balanced economies.

#### The problem of viability

The major problems now facing the European countries are whether they can obtain their objective of viability at levels of consumption adequate to prevent political unrest and how can this objective best be attained. Can it be accomplished by adopting policies which lead to fewer controls and restrictions and permit and depend more largely upon the free operation of a competitive system of prices? Or must highly complex and restrictive methods of control over economic activities be maintained and perhaps enlarged?

When production was small and inflationary dangers acute, the need of controls was incontrovertible, but the situation has now changed.

Examples of a minimum of restrictions are found in the case of Belgium and Switzerland. Considerable progress toward the diminution of restrictions can be found in Italy and to some extent in France. Britain, on the other hand, has been most reluctant about relaxing restrictions and in its international policies seems to be moving toward more rather than less restrictive policies and agreements. The Netherlands also has more rigid controls than many other countries. It is striking that relaxations have been greater in countries that have shown greatest progress toward attainment of balance. It should not necessarily be concluded from this, as is done by a great many people, that the relaxations have been the basic cause of the improvement; it is likely that increased output has made relaxation possible. But there is a growing belief that the restrictions are not bringing about desirable solutions and that their reduction or removal would force many needed adjustments that might not otherwise be made.

Another aspect of this problem, which cannot be ignored, is the possible cost of any widespread relaxation of restrictions. In Belgium, rather drastic monetary measures were adopted early in the postwar period. In France and Italy very substantial inflation occurred before the price system began to operate as an effective regulator. Would more widespread relaxation of controls raise the threat of further inflation? The political repercussions of a renewal of inflation must be kept in mind. While it is possible that productive capacity is now sufficient to prevent inflation, that is very uncertain. The risk of inflation might be avoided by assuring adequate additions to European aid. It may be that relaxation of restrictions, together with increased aid at the beginning, might bring about the needed adjustment of European economies more rapidly and with less ultimate aid than the present approach. But that solution would require legislation of broader scope than that now being enacted.

American officials must of necessity share in formulating decisions about these matters and American policies--for example, about tariffs, farm price supports, and limitations on the use of aid funds--will have an important bearing upon the success or failure of whatever course is followed. It should be emphasized in this connection that probably no informed or responsible person believes that existing restrictions can be completely or even largely abandoned; the principal issue of controversy is whether Europe will move toward greater freedom or toward more restrictions.