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A Survey of Surveys — Europe in 1950 and 1951
J. Herbert Furth 6 pages

NOT FOR PUBLICATION

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J. Herbert Furth

A Survey of Surveys -- Europe in 1950 and 1951

In recent years, the economic and political fate of the United States has become more and more intimately connected with the economic development of the European continent and the British Commonwealth. It is fortunate that the Surveys published by the ECE 1/ make it easy for every American concerned with international problems to become acquainted with the economies of these regions.

The Surveys give a concise and yet complete picture of basic events and problems; they describe and analyze the changes in production and trade and pay particular attention to the problems of domestic inflation and the balance of international payments. In addition, the Survey for 1950 contains a valuable discussion of the raw material situation, and the Survey for 1951 devotes special chapters to the economic development of the Soviet Union and to the coal situation. Each Survey presents more than 100 statistical tables including virtually all the data needed for understanding the economy of Europe.

If the authors of the Surveys were content with description and analysis, no more would have to be said about their work except to praise it. However, they also offer advice on the solution of Europe's economic problems and try to judge the policies adopted by the European authorities. The ECE staff includes some of the outstanding economic experts of our times, who have the right, and indeed the duty, to make their views known to the public. Nevertheless, these additional functions also entail additional responsibilities, and the authors must be prepared to face criticism looking beyond technical accuracy and competence to the validity of their proposals and the soundness of their judgment.

The result of that criticism is disheartening. All too often, the authors' predictions fail to come true and their policy recommendations prove unwise. The very fact that the authors of the Surveys are probably the best qualified group of economic experts in Europe, makes their errors of judgment a particularly serious matter.

1/ Economic Survey of Europe in 1950; Economic Survey of Europe in 1951. Prepared by the Research and Planning Division, Economic Commission for Europe.

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This review briefly discusses three topics -- inflation in the United States, inflation in Europe, and exchange rate policies -- where the shortcomings of the Surveys are felt to be most apparent. It should be understood, therefore, that this selection is likely to be one-sided: the authors did much better in other matters. However, many of the other topics were not particularly controversial and it would have been surprising if a group of brilliant economists had not been correct in their diagnosis. Moreover, the criticism does not imply that this reviewer would have had a higher batting average if he had happened to participate in the game: it is easy to judge events correctly in hindsight. Still, the pattern of the mistakes made in the two Surveys seems to warrant some conclusions which may help the authors to avoid future repetition.

Inflation in the United States

The authors of the Survey for 1950 were deeply concerned about inflation in the United States. They calculated for 1951 an "inflationary gap" of $20 billion, resulting from a rise in "real" output of $20 billion as against an increase in monetary demand by $40 billion. They predicted that this inflationary pressure would lead to a rise in imports and fall in exports large enough to produce a "sizeable" deficit on current account. The change in the balance of payments would add to the inflationary forces abroad (pp. 23-26). Moreover, "the rate of increase in U. S. demand is so large that supplies available for Europe may actually fall" (p. 59), and the inflationary pressure in the United States would make it impossible for this country "to provide exports of manufactures ... to meet the rise in foreign demand" (p. 159).

In the Survey for 1951, the authors conceded that inflation had come under control in the United States, and attributed this event mainly to the restrictions on new construction and "the remarkable quiescence of consumer demand" (p. 6). The authors failed, however, to acquaint their readers with the general anti-inflationary credit policy of this country and did not try to correlate the "remarkable quiescence of consumer demand" with that policy. They conceded that "actual developments so far might seem to have gone counter" to the prediction of falling exports -- actually, exports rose from 1950 to 1951 about 46 per cent by value and 28 per cent by volume --, but made the excuse that exports had been "at a relatively low level in the first half of 1950" (p. 92): as if the authors had not known this fact when they made their prediction. Moreover, the authors spoke of a "decline in U. S. imports" (p.7) despite the fact that the volume of imports remained almost constant while the value -- which is decisive from the point of view of balance of payments considerations -- rose by 23 per cent.

The authors also conceded that there has "undoubtedly" been "exceptional flexibility" in the American economy, "which has no parallel elsewhere in the conversion of military production and the struggle against inflation". Lest this admission be taken as an acknowledgment of the virtues of a free economy, they hastened to add that "the one other big industrial economy where such flexibility exists is the Soviet Union" (p. 7). The basis of this statement remains obscure since according to the Survey itself (pp. 141 and 144) the Soviet Union, unlike the United States, since the end of the war had continuously diverted a higher percentage of its output to military purposes and therefore did not have to face the problem of rapid reconversion at all.

Inflation in Europe

In the Survey for 1950, the authors were also concerned with the danger of inflation in Europe. They even hazarded the prediction that "the inflationary situation has already developed to such an extent that countermeasures taken now are likely to prove too late" (p. 21). In view of the European armament programs they felt it "safe to conclude that the increase in civilian consumption and investment will be extremely small at best"; the possibility of achieving the necessary adjustments "without further inflation seems remote" (p. 139).

Actually the year 1951 was much better than these predictions assumed. Nevertheless, the Survey for 1951 complained that the European governments did not follow the advice proffered by the Survey for 1950 — of which more will be said later —; indeed, many European governments, instead of employing "a very extensive, carefully coordinated system of controls", were induced "to seek escape during the year through a severe rationing of credits"(pp. 107-108). It is not quite clear whether the use of the term "rationing of credit" instead of the more usual "anti-inflationary credit policies" was meant to make credit policies more acceptable to the advocates of rationing and other direct controls or less attractive to the opponents of such measures; in any case, the choice of the term seems to obscure the differnces between policies that operate through the market mechanism, and direct controls that seek to nullify the operations of that mechanism.

The authors did not deny that these policies may have been successful in some instances, but they felt that any success has been purchased at too high a price. In a number of countries the policies have led to "reductions in public investment . . . . It is difficult, however, to believe that the average quality of investment, from the point of view of its long-term contribution to higher productivity, has not been reduced by this concentration of cuts on a few basic industries or services" (p. 117).

This reviewer finds it difficult to believe that public investment would invariably make a greater "long-term contribution to higher productivity" than private investment in plant and machinery. However, the difference in opinion might be settled if the authors included in next year's Survey a chapter comparing productivity in countries relying on public and on private investment.

Apart from these general statements, the authors attacked again -- as in previous volumes -- the policies of those countries that have adhered to the principles of a market economy. In the Survey for 1950, they stated that Germany "is suffering from a lack of synchronization between the rates of expansion of the various sectors of the economy, which Government investment policy has so far done nothing to correct" and that therefore "the expansion of western German output is likely to be permanently hamstrung" (p. 37). Germany's temporary EPU deficit was taken to show "the incompatibility between the premature dropping of selective controls over imports and the internal expansion required to absorb idle resources of men and machines" (p. 128). Worst of all, "in western Germany, the determination of the direction of investment has been left very largely to individual entrepreneurs. Those with profits to spare have been allowed to invest them as they wished" (p. 151). The authors opposed such practices: "What is needed is a highly differentiated policy . . . likely to involve a much greater degree of conscious control of the working of the economic system than has been the practice since the monetary reform of 1948" (p. 152).

Although the German authorities did not follow that advice, Germany in 1951 increased its industrial and agricultural production more than any other major industrial country, kept the rise in prices and the cost of living at a minimum, brought its over-all foreign trade balance into equilibrium, and converted its EPU deficit into a sizeable surplus. The authors of the Survey for 1951 were not satisfied with these results. "In western Germany, where the Government attaches considerable importance to credit policy, the volume of credit . . . did not rise as much as would have been required to finance easily the rapidly rising value of agricultural and industrial production an external trade . . . In any case the credit policy seems to have hampered the development of production of consumers' goods" (pp. 121-122). Actually, German bank credits in 1951 rose 30 per cent. The authors also felt that Germany (like Belgium and Italy, where the criticism was better justified) "made no inroads whatsoever into their heavy unemployment" (p. 124); actually, industrial employment rose 8 per cent during the year, and the ratio of unemployment dropped 12 per cent. Finally, the authors found that "in western Germany industrial wages have stagnated" (p. 112); actually, real industrial payrolls rose about 10 per cent during 1951, but it is true that this rise compares unfavorably with the increase of about 15 per cent during 1950.

However, Germany was not the only sinner. In the Survey for 1950, Austria and France were accused of overgreat "financial caution" (p. 52). Unlike Germany, these two countries apparently took the criticism to heart and in the Survey for 1951 France had to be told (and the same could have been said about Austria) that its "expansionary credit policy . . . was a contributory factor in a major inflation" (p. 122).

In the Survey for 1950, the United Kingdom was advised to increase its imports from Europe and to divert its "own exports away from Continental European markets to overseas sterling area markets" since "the most difficult problem in EPU may prove . . . the credit position of the sterling area. While the slowing down in the rate of growth in this position in March /1951/ may point to some easing of the problem, it seems more likely that sterling area raw materials will continue to be avidly sought after by western European countries, tending, at prevailing high prices, further to accentuate the British surplus" (p. 129). The U. K. Government apparently believed in the soundness of this judgment, and in the second half of 1951 converted its EPU surplus into a deficit of $783 million. As a result, the Survey for 1951 had to devote several pages to "the payments crisis of the United Kingdom", conceding that "in the event, the increase in imports was much larger than expected" (pp. 81-82).

Exchange rate policies

The authors of the Survey for 1950 proposed the adoption of repeated changes in exchange rates as a method of anti-inflationary policy; in particular, they advocated a substantial appreciation of non-dollar currencies in order to minimize the impact of increased dollar prices of raw materials on the non-dollar world.

The proposal was explicitly based on three assumptions; first, that dollar prices of raw materials would not substantially decline; second, that the United States, because of raw material shortages, cuts in civilian consumption, and general inflation would be unable to increase exports; and third, that the European countries would similarly be unable to increase exports (p. 159). Since all these assumptions proved unfounded, the proposal was unjustified according to the standard set by the authors themselves. However, it would have been unsound even if the assumptions had been more realistic.

The authors conceded that the devaluation of most European countries in 1949, which they had opposed at that time, contributed to the improvement in the balance on current account of the devaluing countries; somewhat more cautiously, they also conceded that devaluation "may have contributed to the general upturn in economic activity and the expansion of world trade" (p. 106). They tried to show, however, that upward revaluation in 1951 would not have the reverse effect; they believed that

the fall of imports prices (in local currency) would not lead to a rise in imports, nor the fall of export prices (in local currency) to a decline in exports so that the balance of current international payments of the revaluing countries would not deteriorate (p. 162). This argument is pure speculation: the weight of evidence, including that of the devaluation of 1949 cited in the Survey itself, points to the contrary.

Furthermore, the authors conceded that their proposal would make it necessary to vary exchange rates quite frequently: "the monetary authorities should be able and willing at any time to adjust the rates . . . in either direction and to whatever extent seems appropriate" (pp. 162-163). The authors did not envisage any international consultation; moreover, they conceded that acceptance of their proposal "might" make necessary the imposition or strengthening of import controls (p. 164, note 2). Their recommendations thus did not aim at liberalizing international trade and payments relations, but on the contrary, at enabling any country "to insulate its own price system from external influences" (Survey for 1951, p. 119).

The authors took their stand apparently because they believed that the market-price mechanism was unable to produce a workable economy. This conviction explains their distrust of credit policies that are based, at least in part, on the working of the interest rate (i.e., the price of money capital); their preference for continuous government manipulation of exchange rates (i.e., the price of foreign currencies); their criticism of the economic policies of the United States and of those European countries that adhere to the principles of a free economy; their skepticism as to the liberalization of inter-European trade and finance (Survey for 1949, pp. 105-107);[1] their belief in the superiority of public over private investment; and even their discussion of the significance of changes in the prices of raw materials (Survey for 1950, pp. 5-10) and of coal (Survey for 1951, p. 167).

Traditional economics may have taken the functioning of the market-price mechanism too much for granted. The role of prices, and especially of interest and exchange rates, needs further clarification, and in some instances a policy based on other than price considerations may indeed be superior to a policy relying exclusively on the forces of a free market. However, on the basis of our present knowledge of economic behavior, a dogmatic rejection of policies utilizing the market-price mechanism would be no more justified than a dogmatic rejection of all alternatives. If the authors of the Surveys appreciated the achievements of traditional economics as much as they appreciate its shortcomings, they might have a better chance to see their predictions come true and their advice prove helpful.

In the meantime, the theoretical economist will greatly profit from the stimulating ideas expounded by the authors of the Survey, but the practical economist will do well to approach them with caution.

1/ See this Review, July 18, 1950.