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THE ECONOMY OF WESTERN EUROPE

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COLONEL WATERMAN: Our subject this morning is the economy of the western European nations. To cover this subject in one lecture, with countries as highly developed as the European countries are, is no easy task; but I believe that we have the man who can do it.

As his biographical sketch indicates, our speaker this morning has had very wide experience in economics and government, culminating with his occupation of one of the most vital posts in the administration of our foreign economic policy--acting administrator of the Economic Cooperation Administration, now the Mutual Security Agency.

His status among economists was fully recognized last winter when he was asked to address the annual convention of the American Economic Association. He spoke on the revival of western Europe. I was there, and in my humble opinion that was the highlight of the entire convention.

To address us on "The Economy of Western Europe" we have this morning Dr. Richard M. Bissell.

It is a great pleasure and privilege to welcome you, Dr. Bissell, to the Industrial College of the Armed Forces.

DR. BISSELL: Gentlemen, I am going to address myself to the subject of the economy of Europe. I am going to try to emphasize what I think is an appropriate direction given the subject matter of your course, Europe's economic potential. There is a great deal that I will leave unsaid in my original remarks; I am going to keep those to a reasonably limited scope. I hope that you will raise, when we come to the question period, any issues that you have in mind that I have not already covered.

In spite of my subject matter, I am going to tell you remarkably little about Europe's economic potential. The reason is that, aside from a few general statements that I can make and a few figures of rather illustrative significance that I will read off to you, I think you can really find out much more quickly and painlessly, by consulting a certain amount of published material, the magnitude and the general characteristics of the European economy. Certainly you can pursue the details better that way than I can for you. I do want, however, to begin with a few facts and figures as a starting point to an answer to that question.

You all know the area that we refer to as western Europe, but for my purposes I am going to include all the countries in the

European Recovery Program, that is, Greece, Turkey, and central Europe, as well as the countries in the north and west. You know that with a few exceptions, such as the countries of Greece, Turkey, Portugal, and the southern half of Italy, this is the second greatest industrial area in the world--the greatest other than North America itself.

It is a densely populated area; its principal indigenous resources are coal, iron ore, some water power, and a certain amount of timber, and not much else; this area is heavily dependent by reason of the size and complexity of its industrial structure, its dense population, and its limited resources, on both imported foodstuffs and feed and imported raw materials.

Broadly speaking and historically speaking, western Europe has lived as one of the world's workshops; and, to an extent, of course, that is not true today and has never been true and will not be prospectively for 50 or 75 years; it has lived by importing foods and raw materials--processing the raw materials and paying for its imports by exporting manufactured products.

Now, it is perfectly normal and quite basic to the general European economy to explain most of its problems in terms that do not take in either the Marshall Plan or the European Recovery Program (ERP). One of the main points that I want to make rather definitely this morning is the basic fact that the dependence of Europe on imports to live and to produce, and its dependence on exports to pay for imports, is one of the main limiting factors on its economic potential, whether for war or peace.

Before I go on to any further analysis of what follows from this and its implications, let me give you a few figures to indicate the magnitude of the European economy and to do so somewhat in relation to other regions in the world.

Most of you are familiar with the meaning of "gross national product"--a measure of the output of an economic system, a measure, in other words, of the current rate of production of goods and services of all kinds and sorts in an economy. Europe's gross national product--again let me remind you that when I refer to Europe I refer to the countries in the ERP; it really includes all of the non-Soviet countries of Europe with the exception of Spain and Yugoslavia--is running somewhere between 150 and 175 billion annually. That is just about half the gross national product of the United States.

Several months ago, when I was still with the Mutual Security Agency, we asked the Central Intelligence Agency for an estimate of the gross national product of Russia and the satellite countries, for comparison. The reply was that if we would tell them just what figure and what general order of magnitude we wanted, they would find evidence to support that figure within a very wide range. That honesty on the part of the Central Intelligence Agency has led me to believe that comparisons in this particular respect between western Europe and the East are not very fruitful. So I have no figures to give you.

But, as a measure of the economy as a whole, let me read off a few more figures to show now what the gross national product is. Let me give you a few specific production and population figures for comparison.

First, on population--for eastern Europe, that is, the USSR and the European satellites, 296 million in 1950; for western Europe, for the countries that I have included in that term, 276 million; for the United States, 153 million; and for Canada, 14 million.

Those figures are important. Naturally, the 276 million population of western Europe includes a much higher proportion of industrial labor than the 296 million for eastern Europe. By and large western European labor is at least 50 percent more productive; that is to say, the gross output per man-hour is certainly at least 50 percent higher in western Europe than in the East, partly and immediately because it is a much more heavily industrialized area.

So if we are thinking of this in terms of a list of assets, asset number one, the fundamental asset, is this 276 million population, including the second largest pool of industrial trained manpower in the world, including a population that with a few minor exceptions, such as Australia, New Zealand, and Canada, is certainly the only large pool of relatively high productivity and high standard of living of industrial and agricultural labor outside the United States.

A few production figures are also useful. These figures for 1950 are as follows:

First of all, as a measure of agricultural production, bread grain and feed grain: eastern Europe, 114 million metric tons; western Europe, 67 million; United States, 133 million; Canada, 23 million. In other words, the western European countries' agricultural production, even though very secondary in importance to the industrial, is about half that of the United States and just a little bit more than half that of Russia and the European satellites taken together.

Under the heading of industrial production, I will just take one or two figures. Crude steel: eastern Europe, 35 million metric tons; western Europe, 51 million; United States, 88 million in 1950. Those figures have gone up in the intervening two years, I imagine, in relation to about the absolute increase in the United States; and possibly the largest percentage increase has been in the case of eastern Europe.

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But it is worth pointing out that even as of today, western Europe's steel capacity is at least 50 percent higher than that of Russia and its satellites taken together.

Motor vehicle production is perhaps not so important in itself, but it is important as indicating the magnitude of the economic structure. The estimate for eastern Europe is 530,000 vehicles, for western Europe 1,577,000, compared with about 8,000,000 for the United States. So that particular segment of industry had a three-to-one advantage in western Europe over Russia and the European satellites.

In coal, another and probably a better measure of the general magnitude of the industrial complex, the figures are very much closer. In 1950 roughly 300 million tons were produced in eastern Europe, 440 million tons in western Europe, and just a fraction over 500 million tons in the United States.

In electricity the figures I have here are in billions of kilowatt hours. Again for 1950, eastern Europe, 132 billion; western Europe, 245 billion; and the United States, 388 billion.

If you take coal and the electricity production, a measure having a rather general significance as reflecting the size of the industrial structure as a whole, again the advantage of western Europe over eastern Europe is somewhere between 25 and 50 percent.

It is only in crude oil production that eastern Europe has an enormous advantage over western Europe. And there I think the reason is quite obvious. It is simply that western Europe has only negligible petroleum resources.

Those are the only figures that seem to me worth while as a measure of the general magnitude of the industrial complex of western Europe. I will now add a few qualitative and general comments by way of further characterization.

Western Europe has a unique and extremely highly developed transportation net of all sorts. It suffered greatly in the war, but there is no segment of the economy of western Europe where reconstruction has been more complete. I think it is fair to say that today, without any question, the whole European rail net has been restored and its capacity is undoubtedly considerably greater than prewar, with the possible exception of western Germany. As a matter of fact, I am inclined to think that excessive resources have been devoted since the war in western Europe to the restoration of transportation, including not only inland transportation--rail, highway, and canal--but also the ports; and even there the war damage is completely restored. I would guess that today the capacity of the major ports of western Europe, beginning with Trieste at the head of the Adriatic and going around the shore line of the Continent to Antwerp, Bremen, and Hamburg on the North Sea, is now fully up to prewar, if not in excess of it.

The volume of cargo that has been handled through these ports has been running considerably higher in both directions than in the years immediately after and preceding the war. And there is every evidence that there, as here, there is not much excess capacity; but the ports are in no sense a limiting factor.

As to their utilities--gas, electricity, communications--there, too, the task of restoration is complete. Particularly in electrical generating capacity, western Europe's capacity is now far above prewar. Again, an extremely high investment of capital funds in expanded, replaced, or improved real assets has continued ever since the war. It has been heavily concentrated in industry and more particularly in electrical generating capacity, as it has been in transportation.

But, even so, demand is not fully met. Whereas it is not true with respect to transportation, it can be said that one of the physical limiting factors on the production and on the economic expansion of western Europe today is the availability of electric power.

I will mention the coal industry at this point, because I think that for the first time coal production is one of the physical limitations on Europe's potential. Coal production today is running only about the prewar rate. In France the prewar rate of production has been pretty continuously exceeded for the last two years. But in both the Ruhr and England, the two really large coal industries of western Europe, production has not yet exceeded or in some cases even reached prewar.

This is no doubt the most important single physical limitation on Europe's economic potential. You are probably aware that in two important periods since the war this limitation has been so severe that Europe has imported coal in very large volume from the United States. The second of those periods of major coal imports really covered most of the calendar year 1951 and continues, though at a diminishing rate, up to the present time.

At the peak which was reached approximately last November, Europe was importing coal at a rate in excess of 35 million tons a year from this country. When we realize that 100,000 tons of coal a year are 12 to 13 Liberty ships of full cargo, and that a million tons of coal are 100 to 125 sailings from United States ports, you can realize something of the magnitude of this operation--the importation of coal at any such rate.

In the field, then, of physical capacity let me try to sum up what I have said so far and get on to the other, and I think on the whole more important, parts of this subject.

Western Europe has the second largest industrial complex in the world, second only to our own, or, more broadly, to the industrial structure in North America. I suppose that if one had to try to give only a very rough estimate of the comparative magnitude of the two, one would say that the European structure of industrial capacity is somewhere between half and two-thirds that of the United States. Even though that sounds like a small figure for a population of 276 million compared with our own 153 million, that industrial structure is probably on the order of 50 percent greater in size, potential, actual output, and resources than the industrial structure of the whole Soviet world, excluding only China. And China's industrial structure and capacity are extremely small.

Compared, then, with North America, Europe is definitely a junior partner, measured by its economic potential; but compared with the Soviet bloc, western Europe alone has the resources very nearly in manpower, and fully the resources in production, if not in raw materials, to be the equal by itself in economic strength of the whole Soviet bloc.

At least one implication can be drawn from this very scattering and brief array of facts that I have laid before you. If you think of western Europe for the moment, not as a collection of allies but rather as an area conceived of as a potential prize of warfare, as people whom we can very effectively win over to our side of the conflict with the Communist world or whom we can possibly lose to the other side in that conflict, you can see from the figures that I have quoted just exactly how important a prize this is.

I am sure you are also familiar with the fact, that again I think is implied in what I have already said this morning, that the economy of western Europe could be highly complementary to the economy of Russia and the satellites. And indeed I will remind you that historically Russia and eastern Europe as an area was complementary to western Europe. Russia and eastern Europe even today have considerable exportable surpluses of basic foodstuffs and feed grains. It does have large exportable surpluses of lumber resources, one of the basic resources in which western Europe is deficient.

Those are perhaps the two most important single ones. But the eastern bloc also has exportable surpluses, or could develop exportable surpluses, of certain nonferrous metals and alloying metals.

Taken together, then, the first and most broadly significant of these figures is that on our side, on the side of what we call the West or free world, the resources of western Europe, added to ours, give a gigantic economic superiority over the eastern bloc. But if western Europe were shifted to the other side, there would be relative equality, if not full equality, in economic strength between the two, as well as a very much greater disparity in sheer untrained manpower than the disparity that already exists.

Western Europe is second only to the United States, the greatest industrial complex, the wealthiest, and the most efficient body of producers in the world. It is for that reason that it is so crucially an objective of policy.

Those are a few of the basic facts about Europe's economic potential. I have mentioned two physical limitations on its potential. I want to mention now probably one other fact that I have referred to in general terms, one other limitation that operates in a somewhat different fashion. I have already referred to Europe's dependence on imports to both live and produce. I have figures for several of the major countries here that I would like to read to you to drive home this point.

First, the net food imports as a percentage of the total food consumption.--For Belgium the figure is 44 percent; Britain, 67 percent; Western Germany, 37 percent; the Netherlands, 27 percent. These are the four countries that are most dependent. But, as you can see if you take these four highly industrialized countries--in fact, with the exception of France, these are the four principal industrial producers in Europe--they have to buy from abroad somewhat between a low of 27 percent for the Netherlands and a high of 67 percent for Britain of their foodstuffs.

On the other side of the picture I have no satisfactory figures for their dependence on imported raw materials. I can only run over a few of the raw materials to make the point.

Western Europe as a whole imports practically all of its crude oil. There is a little synthetic production but very little since the German capacity was dismantled. There is a little crude production in Austria but it is very nearly negligible. Western Europe is almost totally dependent on petroleum imports.

There is very little production of nonferrous metals other than aluminum from domestic raw materials in western Europe. Europe does not import much iron ore unless one counts shipments across the Mediterranean as imports. They come from a politically controlled and geographically contiguous area; so I think that it is hardly proper to call them imports.

The largest and most important single source of Europe's iron ore is Sweden. Its location raises a problem of vulnerability of supply lines in the case of war. But that is a strictly economic problem. Iron ore and coal are Europe's two great indigenous resources.

As to fibers there is very little production in Europe. With the exception of a small amount of wool and a very little cotton, it is almost totally dependent on imports.

As to forest products, I do not have accurate figures. It is perhaps too heterogeneous a category to be summarized in one figure. But I would say that normally--and by "normally" I mean when deliberate overcutting is not being carried on--western Europe is dependent on imports for probably two-thirds of its forest products, that is, newsprint, lumber for construction, for pit props, and for other things.

So in summing this up, one has to emphasize on the one hand Europe's tremendous assets, its very great strength in population and as producers, and as an aggregation of capital assets useful in production. One has to emphasize a couple of physical limitations, like coal and electric power. But those are limitations that can be removed and are in the process of being removed pretty rapidly.

A much more fundamental basic limitation is its poverty in certain natural resources, its limitation of land area, and consequently its crucial dependence on imports from the rest of the world, a dependence that is matched, I suppose, only by that of Japan among all modern powers.

Now, having made these comments on the physical facts of life about Europe, let me proceed to some comments of a more analytical nature, some more, if you like, economist's comments on the current economic situation of Europe, its recent past in relation to institutional strengths and weaknesses, and on the implications of these further, these nonphysical, facts for our own power.

Let me start this part of my remarks by saying that, serious as are the limitations of inadequate coal production and of inadequate basic materials, undoubtedly the most important limitations on Europe's economic potential are not the physical limitations. They are, it seems, if you examine them closely, political and economic limitations. And even the economic limitations will reduce in the end to political limitations.

In a sense what I am saying, gentlemen, in this one remark is that I believe that the state of mind of the European, his health, the degree of health or illness of the whole social organism, is important not only to the European's will to resist, which is so often a subject of discussion and speculation in this country, but, in a sense it is the crucial factor that determines Europe's strictly economic potential. And that is really the point that I want to develop by these few remarks about this situation.

You will remember that the immediate postwar years were ones of physical reconstruction and of rapidly intensifying economic crises and dislocations. You will remember that this reached a climax in the winter of 1947-1948, which was a disastrously cold winter; it followed a period of serious drought and near crop failure over much of Europe. It was that winter which saw Europe's economic position at its worst.

Most of you will remember that the outward and visible form of this disease in that year which climaxed the economic dislocation was Europe's foreign exchange deficit; and all I mean by the phrase "foreign exchange deficit" is a measure of the extent to which Europe had to buy from the rest of the world in excess of what it sold to the rest of the world. The figure that I think is pretty generally used as a measure of the foreign exchange deficit in 1948 was of the order of 8 billion dollars. As a percentage of Europe's gross national product, which was then running just over 100 billion dollars, it is not large; but this was quite literally a measure of the extent to which the Europeans were living beyond their means.

Why? Well, again I think that the background is broadly familiar to you. In any case I don't think it is worth spending very much time on it. But the limited production, the failure of their industrial and agricultural production to recover from the war, was one of the reasons. Europe was importing food and raw materials heavily because of its dependence on them; but Europe was not producing enough to pay its way in the world.

If one looks back to that failure of production, one finds monetary disorder and chaos in the form of inflation, suppressed inflation in the north, physically open and galloping inflation in central and southern Europe. One finds those as perhaps the main immediate causes for the failure of production and for the failure of those goods that were produced to find their way into the export markets.

This climax of economic dislocation in 1948 was in a sense the reason for, and it also coincided with, the beginning of the European Recovery Program. Without going into elaborate argumentation as to the reasons for that, or its accomplishments, that program did accomplish this purpose: It gave the Europeans a breathing spell of several years during which time they were enabled to live beyond their means while they got production going and got their economy reorganized.

But I think it is fair to say that, by every measure one can examine, the process of recovery--the reorganization of the European economies and the setting of them in motion--had proceeded extraordinarily far by the middle of 1950, that is to say, by the outbreak of the aggression in Korea. By that time industrial production in western Europe as a whole was at least 30 percent above prewar and agricultural production was at least 2 or 3 percent above prewar.

If the recovery of agricultural production does not sound very impressive to you, I would remind you that it was a very much more rapid recovery than occurred after the war of 1914-1918. It is a lesson of both those wars, and of many other catastrophes as well, that agricultural production does not and cannot be brought back as fast as industrial production.

Not only had production recovered by mid-1950 but, to a degree that we are now inclined to lose sight of, Europe had gotten control of inflation. By mid-1950--we were just emerging in this country from a very mild economic recession or, you might say, inventory liquidation phase that had begun a year earlier--I think it is fair to say that in every major European country inflation had been brought fully and effectively under control.

That job was accomplished first in Belgium. Switzerland never had a period of postwar inflation. I have rather ignored that peculiarly favorable position of Switzerland in these remarks. But this had been accomplished first in Belgium and then in Italy, in both cases really even before the start of the Marshall Plan. The German currency reform was carried through under the military government. Beginning with the currency reform, inflation was at an end in Germany.

In Britain and the north European countries the problem of inflation all through this period has not been one of open inflation, of visibly rising prices and spiraling wages. It has been a problem of concealed, restrained, and controlled inflation; that is to say, of chronic inflationary pressures held in check only by direct price controls of the OPA variety and by various kinds of controls on wage rates, usually exercised through and with the cooperation of the labor unions. That kind of inflation was probably less destructive than the open inflation of France and Germany, but it nonetheless was one of the main reasons for the inability of countries like the Netherlands, Norway, and Britain in the early postwar years to pay their way in the world. But by mid-1950 in every one of the three countries above mentioned, which had been the ones most characterized by repressed internal inflation, major headway had been made in bringing that repressed inflation to an end. So the picture by mid-1950, if one looks at production, at internal finances, and at government budgets, was one of very considerable and complete recovery.

That, of course, was reflected in European foreign trade, that is, in Europe's economic relationship with the rest of the world. Indeed, in the fiscal year 1950-1951 Europe's dollar deficit with the world as a whole was just over 500 million dollars. It had been reduced, in other words, from over 8 billion in 1948 in that two and a half year period to only one-sixteenth of that amount.

I think it must be said in all honesty that this is a very encouragingly low figure. One of the reasons that the figure for Europe comes out as low as half a billion dollars is that there was still in progress in mid-1950 a return flow of capital, especially in the sterling area, and to some extent in the other European countries, following the currency devaluations that took place in the fall of 1949. That return flow of capital funds made the financial picture seem more favorable than in fact it was.

But even if one allows for that return flow, it is fair to say that the dollar deficit by mid-1950, by the outbreak of the Korean conflict, was running at a rate considerably under a billion dollars a year. And that means that seven-eights of the dollar deficit or dollar gap in Europe with the outside world had been closed.

The Korean violence had an almost disastrous impact on the economic situation of Europe, or at least of the two most important single countries in Europe--France and Britain. Its immediate and short-term results, especially as measured by the dollar gap which is the figure I have just been talking about, were favorable, because the first consequence of the Korean aggression was a wave of inflationary buying in the United States, which spread throughout the world and consequently and suddenly enlarged the export markets for European products.

A result of this was that within a matter of months Europe's rate of exports and export earnings went up, I suppose, a third; and during the autumn of 1950, about four to eight months after the outbreak of the fighting in Korea, there was a period of a few months when Europe's foreign account, when Europe's trade with the rest of the world, was for the first time since the war very nearly in balance.

Incidentally, it was a period when this country was losing gold to the rest of the world at a rate, as I remember it, running over 3 or 4 billion dollars per annum. So that in a very few months after the outbreak of the Korean conflict, the effect--and it turned out to be a very temporary effect--was that Europe was enabled to earn money from the rest of the world and thus to close still further the gap in its international trade.

At the same time, however, the Korean conflict detonated a violent increase in commodity prices throughout the world, both in basic foodstuffs and even more of an increase in major raw materials. And those sharp price increases in turn set off a new wave of inflation, especially, as I have indicated, in France and Britain.

Most of what happened in the European economy since that time is a matter of very common knowledge and very recent history. I think it can best be summarized in this fashion: that in Italy, Germany, Belgium, the Netherlands, and Scandinavia, that is, in most of the western European countries outside Britain and France, their monetary authorities and also the central banks managed to contain the new inflation that was set off by the Korean violence. Generally speaking, today there has been, there as here, a marked rise in the price level, in wages, and in wholesale and retail prices; but these price increases have leveled off and there is every indication that currently in most of Europe, as in the United States, there is at least a lull in the inflationary spiral. Inflation is well contained.

Now, in this process it is fair to say that in some of this list of countries that I have mentioned there has been a very sharp increase in industrial production. Again it is a close and obvious parallel with our own experience in the United States. In Germany just before Korea, industrial production was still running a little bit below prewar; but by now it has gone considerably above prewar and for 1951 as a whole has been about 7 percent above prewar. In fact, by the end of 1951 the rate of industrial production in Germany must have been running 15 or 20 percent higher than in the prewar years.

This is a rather favorable picture in numerically the majority of the western European countries. But Britain is in the grip of one kind of economic crisis and France is in the grip of another. In the case of Britain it is primarily a foreign exchange crisis. I don't suppose that the domestic inflation is still any worse in Britain than it is here. There has been a very sharp increase in costs, prices, wage rates, and in the cost of living since Korea. The British Government still has the currency under rather extensive direct controls. But the real damage from inflation, as it has existed in Britain, has set in motion another outflow of capital funds. It has raised the cost of Britain's imports and raised it much faster than the value of Britain's exports. It has attracted the output of British industry in excessive volume into the home market, and thus has prevented as large an increase in exports as might otherwise have occurred and as would have been necessary to maintain Britain's international financial position.

The result has been a loss of reserves by the British Treasury, that is, a loss of its hard money holdings, at the rate of over 100 million a month in the last quarter of last year, as I remember it. That has been running at the rate of nearly 50 million a week in the first two months of the current year. These figures have all been made public. There is nothing there that you probably have not already seen.

In the case of France the inflationary crisis has taken on a really different form, an even more serious form. The French Government has never since the war demonstrated strength enough to handle direct economic controls skillfully. It has on the whole kept the economy free from the kinds of controls that they have had in Britain. The inflation in France since Korea has taken to a much greater extent the form of successive increases in prices and wages. My own guess--and it is a guess only, because I don't have the detailed figures before me--is that, broadly speaking, prices must have gone up one-third in France since Korea. That compares with a rise of about 10 percent in this country and a similar rise of something like 11 or 12 percent in most of the other European countries.

This great increase in the price level and living cost in France, the domestic inflation there, has caused its foreign trade position to deteriorate. There has been a tendency for French imports to rise but French exports have fallen off. So that France is having a quantitatively smaller but very serious foreign exchange crisis, like that of Britain; and in addition, France is suffering from all the corroding social effects of unrestrained and progressive, open domestic inflation--a spiral of rising costs of living and rising wages, with all the social pressures that this generates.

Well, I have painted a rather gloomy picture with its center on Britain and France. I don't want to pursue that picture as such any further. I have taken more time that I had meant to on this brief outline of the course of economic events in Europe since the war. My own belief, for what it is worth and for reasons that it would take too long to elaborate, is that Britain's position will very shortly turn for the better. I believe that there are enough inherently temporary elements in this current financial crisis, elements that are bound to work themselves out after a short period of time, so that within a comparatively few months Britain's international financial position will again be under control. There are very important underlying elements of strength in the British economy which I have not mentioned.

There has been a rather different problem and I don't want to go into it very deeply. But let me summarize it by saying that with the exception of these two countries, the situation in most of the countries of western Europe from the economic point of view is quite favorable. There is, I think, a good deal of evidence that the British position will take a marked turn for the better. The greatest question mark, if we want to single out one country from another, remains France.

Now, having made these comments, let me finish what I have to say to you this morning with an enumeration in much more general terms of certain institutional and political limits on the European economic potential, limits that seem to me to be quite clearly perceivable in the pattern of events since the war, that I have hurriedly tried to outline to you.

And here again in connection with this enumeration of factors as limits of Europe's economic potential, may I give one word of warning. I shall be talking here of limiting factors, that is, of adverse factors for Europe's position. I am talking of those because they are in a sense the most interesting facts, in my view, to lay before you concerning the European economy. But because I emphasize them in this fashion, I hope you will not fall into the danger of overemphasizing them. If I gave you a list of the limiting factors on the American economic potential at this moment, I could make it very nearly as impressive; but, obviously, it wouldn't lead us, I think, to a false conclusion about this country. It should not do so as applied to Europe.

The first limiting factor on Europe's economic potential that I think should be very clear from the historical facts I have outlined is its continued and extreme susceptibility to inflation. Probably we too are becoming susceptible in this country to the same disease. But what I want to emphasize is that in Europe by the outbreak of the aggression in Korea the very serious bout of this disease--inflation--that Europe had suffered during World War II was pretty well cured. You will find it argued that inflation was never overcome, but I believe that is untrue and misleading. The fact is that Europe had overcome one bout of the disease two years ago. But what Korea demonstrated is that the patient remains susceptible to this bug; having gotten over one attack of a very serious form of economic illness, it almost immediately succumbed to another.

I think one can inquire behind this very visible fact and one can also see some of the circumstances that make Europe so highly susceptible to the disease of inflation. One of these is the fact that long years of sad experience have deprived Europeans as individuals of any confidence in their own talents. The result is that an unbalanced budget, an act of borrowing from the central bank, a rise in prices or in wages, serious though it may be in itself, and serious as most any one of these occurrences may be to the European economy, you must see that doubly serious is the fact that there has been set in motion a chain of expectations; and consequently the mere expectation of inflation has tended to intensify the phenomenon itself.

What happened in Europe to a degree that was not true in the United States in the fall of 1950 is that higher raw material prices led every trader, every labor union official, every consumer, every producer in Europe to expect another round of inflation; and these expectations themselves brought on another attack of the disease. So what one must say is that one of the major limits on Europe's potential--Europe's continued susceptibility to inflation--grows in a considerable measure out of a chronic and, alas up to this time, rather well-merited mistrust of their own talents.

There is a second limitation on Europe's economic potential that is related to the first, and I think is almost its parent, and that, by the way, has its implications also for our country. This limitation I would call an overload on the fiscal machinery of Europe. By "fiscal machinery" I mean simply the administrative procedures whereby the government collects the taxes and spends them.

By "overload on it" I mean that before the current rearmament program had commenced in Europe, European treasuries were already taking somewhat between 20 and 40 percent of the annual income in taxes and paying it out for various purposes, as contrasted with something in the order, as I remember it, of about 17 percent or 15 percent for the United States at the lowest point in the postwar years. My figures may be a little bit low. I haven't looked them up recently.

What are the consequences of this fact? Well, newspaper reports would make you familiar with the extraordinary difficulties that have been encountered by representatives of this country in the last years in persuading the Europeans to rearm and pay for their own share of their rearmament. You know that the last French Government fell because it couldn't pass through the Chamber of Deputies the tax bill to pay for the rearmament program that the same Chamber had approved the week preceding.

I think that is much more understandable if you realize that the Europeans began to rearm at a time when they were already channeling a quarter or more of their annual income through the treasury. And remember, that is a quarter of the national income of very much poorer economies than ours; and, if you are poorer to begin with, then a quarter of your income may hurt more than it does in a wealthier nation.

Why this overload on Europe's fiscal machinery? There again one can look back not very far and see some of the causes of this element of weakness. One is that the European has assumed a very heavy burden of social security; of consumer subsidies; of similar kinds of schemes for transferring income from the rich to the poor, from the well to the sick, from those of working age to the young and to the aged; to levy taxes on the community as a whole in order to keep down the cost of certain basic foodstuffs important in the cost of living and to provide low-cost housing. The Europeans have gone further than we have ever gone for the whole business of social security and for subsidies to food, to housing, to health, and the like. In that process they have greatly increased the load on the fiscal machinery of their government.

If your Government needs to take, let us say, 10 percent of the national income for these purposes, 6 or 8 percent for national defense, 10 percent to run the Government, and then, beginning from that as a starting point, you are asked to rearm, it is a much more painful process than if the starting point is a little bit lower.

There is still another reason for the overload on the European fiscal machinery, which is also one of the reasons for the continued susceptibility to inflation; that is, there has never been since the war in Europe any revival of the private capital market. Nor has there been anywhere in Europe since the war any revival of the private savings. There have been some profits retained by corporations and plowed back into the business; but aside from that, there have been almost no private savings or private investments of capital. There has been very, very little of that in Europe, because of both the mistrust in the currency and the leveling effect of European taxation.

That has had the consequence that the European governments have had to supply the finances for a great deal of capital formation and have had to invest a lot of funds in new real assets that have gone on since the war. One of the largest elements in the French budget and in the Italian budget is to provide funds for both public enterprises, like railroads and utilities, and private enterprises in the form of RFC private loans to finance private enterprises that over here and in Canada would have been financed in the capital market, and in an indirect way in England. But, although there has been a lot of private investing and of private financing, that has had to be offset by regular government surpluses. Those surpluses and such channeling as has been possible of private savings have increased the susceptibility of the European economy to inflation and increased this overload on the fiscal machinery.

Finally, I will mention something that all of you must have heard of, I am sure. In many of the continental countries there is a weak and inadequate administration of the taxes. It is a normal phenomenon in France and in Italy in particular that the taxes that are on the books simply are not collected. Tax evasion, especially among the upper income brackets, is the normal phenomenon, and runs to a very large magnitude indeed. I think it goes without saying that the inability to collect taxes that are on the books has the same kind of effect as the overload on the fiscal machinery; and that again it makes it more difficult for the Europeans to deal with the phenomenon of inflation.

Well, so much for this final part of my remarks this morning. These are some of the limiting factors on Europe's economic potential. If I may refer back, gentlemen, to my remarks at the beginning, I might remind you that almost all of these limiting factors are institutional in nature, or they grow out of people's attitude, or they are political in nature, that is, they grow out of the democratic desires of the people of these countries. Why can't they collect the taxes? That has demonstrated a weakness and this perhaps indicates a moral weakness in the European middle class.

Why are the people so scared of their money? We will have to admit that they have some good reasons. It is because that man-made institution has worked badly in the past. You do have this overload on the fiscal machinery. They have done so because they wanted pension plans, health plans, low-cost housing, food subsidies, and the like.

So that as we think over these limitations on Europe's economic potential, I think it is fair to say that with the sole exception of the extreme difficulties in their coal industry, which are in part physical limitations, all the rest of these limitations are in the policy, the attitude, or the institutions of the country. And the remedy for these limitations must mean a change in the attitude and an improvement in the strength of these institutions, a change in the political climate.

This is perhaps the most important lesson of all to emerge from the experience of western Europe; it is perhaps the most important point that I can make to you in my appraisal. It is a depressing situation. The situation that I have been presenting here for the last half hour has sounded depressing, since I am talking about our major allies in the world. But remember, gentlemen, it also is a very optimistic situation, because what this means, if my diagnosis is at all correct, is that political changes, changes in climate and attitude, can and are going on which, almost overnight, will greatly strengthen Europe's economic potential. It is within the hands of the Europeans, without great investment or great cost, with such help, material and nonmaterial, as we can give them, to strengthen vastly their economic position. If they succeed in so doing, then as allies they will, I think, fulfill the promise of their physical assets and of their great industrial complex.

QUESTION: The statement has been made that one of the Politburo's greatest errors was in starting the Korean hostilities. Would you care to comment on the Russian use of strategy in regard to Europe?

DR. BISSELL: I suppose it is "open season" for anyone to guess about the Russians; so I don't see why I shouldn't. I think that there are very favorable opportunities for the Russians in western Europe to weaken the whole western Alliance by methods other than hostilities or the immediate and direct threat of war; that the institutional weaknesses of western Europe of which I have spoken are those the Russians can exploit very effectively. I believe that they have exploited them.

The nearest I can come to a direct answer to your question would be this: That even with regard to Europe, Korea can turn out to be a very great mistake, one from which in a sense the Politburo will have to retreat. I think western Europe was ripe three years ago (1948 and 1949) for a revival of the prewar permanent strategy of the popular front; that is, the strategy of directing the local Communist Party to moderate the violence of its propaganda and its position and to try to form alliances with other less radical parties. That strategy worked quite effectively in Europe just before World

War II. It seems to me that the overtness of the attack in Korea has at least temporarily given a strong setback to some of the popular front strategists in Europe.

But the possibility still exists. I think it is in that way that the Politburo might exploit these institutional weaknesses and weaknesses of attitude that I have described. I wouldn't put it beyond the bounds of possibility that within the next year their policy might take a turn in that direction.

QUESTION: Is the western European economy so dependent upon trade with the Soviet bloc that if it should be cut off, it would seriously damage the western economy?

DR. BISSELL: It is sufficiently dependent upon it so that, if that trade were cut off entirely, it would damage the western economy. But the dependence has been greatly reduced in the last two years and is now quite a narrow dependence.

Of the western European countries, Austria is most vulnerable in this respect; it is still getting coal from Poland. A fact which has during the past year been the source of the greatest vulnerability. I believe Britain is still getting some grain from Russia; western Europe is still getting some manganese. I am pretty sure it is still getting some lumber and other forest products. But the one on which the shoe really pinches has been Polish coal.

This list of quantities of commodities going westward has been very greatly reduced. My own belief is that in a relatively short period, over a period of about three, four, or five years, this extreme dependence of western Europe upon small quantities of certain commodities could be virtually ended.

QUESTION: I gathered from what you said that most of the economies in western Europe are directly dependent on what goes on in this country to a great extent. Would you care to hazard some prophecy as to whether, if we had imposed, as one speaker recommended, controls in this country at an early stage, that would have helped to settle some of these problems in Europe?

DR. BISSELL: The answer in my mind is unquestionably "Yes." It depends, of course, on the kind of controls that would have been put in, especially the direct controls. As a purely fiscal opinion I wish that advice had been more largely followed at that time. I think the quick imposition of controls then might have gotten us out of those same direct controls sooner and more painlessly now.

You will remember that many people also emphasized the urgency of prompt and sharp credit controls. I wish we had moved much sooner than we did, on credit controls. My own belief is that a combination of these two, with perhaps a couple of other things that we might have done if we had fully appreciated in this country the inflationary dangers soon enough, could have moderated this inflationary impulse that was generated here in the fall of 1950. I think if that had been done, Europe's position would be far stronger than it is today; and that the price rises would have been less severe in the two countries of Britain and France.

QUESTION: What do you think the United States can do to reduce these political and institutional limitations that you mentioned?

DR. BISSELL: That is a bigger question than I can cover but I will mention a few samples.

For one thing, I have felt for a number of months that more effective leadership from this Government in the direction of a unification of a number of the European economies, especially the continental economies, was something that would hold real promise. This was not just because a unification of those economies would have resulted in the short run in such important economic effects, but because I think it is in a way the key to the problem--to give the people of western Europe a sense that they have a future, that they have something to live for, something to fight for. My own feeling is that for the political systems and the economic systems of 14 small countries to be sort of on the fringes of despair, as a great many Europeans seem to have been, has had a very bad effect.

But I do feel that they are beginning to have now a very real move toward a major change in that respect and a major improvement in the structure of European society. I think that this state of mind is beginning to contribute powerfully to the changes that will overcome these limitations that I have discussed.

I repeat, these are just samples. There are a whole variety of things that we can do as outsiders to help the governments, the labor unions, the business organizations, and all elements in Europe to set in motion the changes that the circumstances seem to call for. I have been a great believer in the thought that it would cost very little money, a very small fraction of what we asked of Congress this year, to launch a most determined effort to get increased productivity in Europe's industry, especially, and also in agriculture.

If we had had a fair sprinkling of cases where productivity was increased, where it was possible to pay higher wages without a rise in prices, and where the condition of European labor was beginning to improve, that would have a great effect in France, Italy, and Germany.

We should try to find a number of ways in which our leadership, the developments to which we give our support, can begin to give the Europeans a confidence in and loyalty toward their own future, which seems to be the element that is so largely lacking and which adds to the number of limitations on them.

QUESTION: Is our star ascending in Europe or descending?

DR. BISSELL: I think that beginning about September 1950, possibly not until a little after that, and running through perhaps to the Ottawa meeting last fall, our star was in a descending phase in Europe. I have a feeling that with the Lisbon meeting it may have started up again. I am inclined to think that if representatives of all branches of the Government conduct themselves wisely in the next 12 months, our star may move up again. But it seems that in this period we have suffered a loss of leadership, a loss of prestige, a loss of the ability to get what we want in Europe.

I don't like to talk so much in terms of gratitude and friendship, because I don't think these qualities are usually an integral part of international relations. I think that what you have to look at is our ability to exercise perhaps effective leadership in getting what we want done in Europe militarily and economically. And I think that our ability to get that done has declined markedly.

QUESTION: Sometime in the last week the British came out with a proposal for a sterling bloc in western Europe. Would you consider that an adjunct to this unified western European idea?

DR. BISSELL: I am inclined to doubt if I would. In the first place, on this matter of European unity, one point that I think needs emphasizing is this: It is finally clear now and publicly on the record--it took a year and a half to get it clear--I don't think it has ever been possible to pool or unify the economies of the continental countries with that of England, because the British won't do it. There is a long background against it; and I think it is psychologically, politically, and in every other way impossible.

I think that what is possible, and what we should be giving consideration to, is the promotion of a real continental European union, which would not include Britain, and which would be another major element in the North Atlantic Alliance and in the free world.

If that is what we are working on, my own feeling is that to tie in the sterling element would probably be a mistake. I have a great deal of doubt, as a matter of fact, whether the sterling area can last indefinitely or very long in its present form. I have never made up my own mind whether we should hope that it would last or hope that it would break up. I am very much on the fence myself as to what we ought to hope for. But it seems to me that on the whole it would probably be a mistake to try to incorporate the Continent and the sterling area in a single economic group of any kind.

COLONEL WATERMAN: Dr. Bissell, you have done a splendid job on a very complex subject. On behalf of all of us I thank you.

(19 May 1952--350)S/VJM