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to the

REPORT OF THE POLICY PLANNING STAFF (PPS/4)

of July 23, 1947 entitled:

CERTAIN ASPECTS OF THE EUROPEAN RECOVERY PROBLEM
FROM THE UNITED STATES STANDPOINT

As indicated in the transmitting memorandum the report of the Policy Planning Staff under reference was prepared on the assumption that it ought to be suitable for release, if this were desired, not only to other departments of the Government but also to Congressional committees and to the committees appointed by the President to study the implications on the domestic economy of aid to foreign countries. This meant, in effect, that it should be capable of sustaining leaks to the public, and it was drafted accordingly.

For this reason, there were a number of considerations which entered into the conclusions reached but which I did not think it advisable to state in the body of the report.

These considerations are set forth below. They are my own. I have not cleared them with the Staff. Reference numbers and letters refer to the corresponding parts of the report under reference.

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-2-

II. NATURE OF THE PROBLEM FROM THE UNITED STATES STANDPOINT

Considerable confusion has been apparent in public discussion in this country as to the distinction between the countries of Eastern and Western Europe from the standpoint of U.S. aid.

At the moment, the countries of Eastern Europe have excluded themselves under Russian pressure. We consider, however, that it would be dangerous to allow the impression to gain currency that if they had not so excluded themselves they would be "entitled" to receive U.S. aid on the same basis as the countries of Western Europe.

There is here a very real and legitimate distinction, both from the standpoint of actual needs of the European countries concerned and from the standpoint of U. S. interests.

Section II of the report was designed, among other things, to bring out this distinction and to put us in a position where we would be justified in addressing our aid principally to the main countries of Western Europe, regardless of any changes which might later occur in the attitude of the Eastern European countries.

UNCLASSIFIED

UNCLASSIFIED

-3-

III. THE ELEMENTS OF EUROPEAN RECOVERY

In drafting this section, it was thought wise to stick to strictly economic considerations.

Actually, any set of events which would substantially restore to people in Western Europe a sense of political security, and of confidence in a future marked by close association with the Western Powers, would itself release extensive recuperative forces in Europe which are today inhibited or paralyzed by political uncertainty. In this sense, we must recognize that much of the value of a European recovery program will lie not so much in its direct economic effects, which are difficult to calculate with any degree of accuracy, as in its psychological and political by-products.

To state this publicly, however, would be a self-defeating act. For the Europeans themselves, the restoration of confidence must be an unconscious--not a conscious--process. They must come to believe seriously in the real value of such an economic program. Obviously, we cannot say to them that the value of such a program lies largely in their subjective attitude toward it. This would only confuse them and

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UNCLASSIFIED
TOP SECRET

-4-

undermine in advance precisely the psychological
reaction which we aim to produce.

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TOP SECRET

V. FINANCING OF UNITED STATES AID

It is almost impossible really to construct in advance a dependable relationship between the way in which funds are placed at the disposal of these European nations and the results to be obtained. There are enormous limitations on the real possibility for influencing the course of events by detailed plans and programs.

But it is absolutely essential that people in Europe should make the effort to think out their problems and should have forced upon them a sense of direct responsibility for the way the funds are expended.

Similarly, it is important that people in this country should feel that a genuine effort has been made to achieve soundness of concept in the way United States funds are to be spent.

It is probably true that what Europe needs is simply further large scale aid from this country in the form of commodities or credits by grant and aid. The distinction between aid granted to specific programs designed to increase production (and hence to take the form of long-term loans) and aid granted for

TOP SECRET
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purely consumption purposes (and hence to constitute straight grants-in-aid) may well be vulnerable to attack on a theoretical economic basis. But it is one which, in the opinion of the Staff, is necessary for the sake of psychological effect here and abroad, and that is why we have chosen to draw it.

UNCLASSIFIED
TOP SECRET

~~TOP SECRET~~
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-7-

VI. CONDITIONS OF UNITED STATES AID

B. Individual Countries

The reference to Public Law 84 is inserted for the purpose of disarming any feelings on the part of members of Congress, particularly of the House Foreign Affairs Committee, that the Executive Branch of the Government has not paid due respect to the feelings of Congress about the safeguards which should surround our aid to other countries. The Staff hopes that in this way it may be possible to prevent the rise of a demand on the part of those circles for the inclusion verbatim in an eventual general aid bill of the conditions specified in Public Law 84.

The reference in this section to instances "where weakness of the internal political structure or lack of qualified personnel render it difficult for a government to devise or implement ... realistic national programs of economic betterment ..." was put in to cover the case of Italy. We hope that it will be possible for us to avoid stating publicly to the Italians that they must carry out specific reforms and accept a U.S. mission to supervise the utilization of our aid. To do this would only present the Italian Communists

~~TOP SECRET~~
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with a ready-made issue which they would accept gratefully and proceed to make the most of. The Staff considers that Ambassador Dunn should be fully informed as to the background of our thinking and that he should find means, when the appropriate time comes, for allowing it to become known to the Italian Government that its best chances of getting aid would be to take the initiative in requesting advice, managerial guidance, and supervisory assistance from this Government.

With respect to the domestic policy of foreign governments on such matters as nationalization and socialization, the sentiments expressed in the report represent the unanimous and strong conviction of all the members of the Staff after thorough exploration of this subject. We recognize that the domestic policies of the British Government are not sufficiently directed to the increase of productivity. We know that they probably represent in many respects a luxury which British society should not be permitting itself at a moment when it is obliged to accept outside aid. We think it essential that the aid program contain an element of pressure which will force upon the British Government a keen sense of its responsibility for increasing production in Britain and will compel it to re-examine its policies from this standpoint.

UNCLASSIFIED
TOP SECRET

-9-

But we are sure that it would be psychologically fatal for this Government to raise specific demands or advance specific criticisms in connection with an aid program. If the British are indeed incapable, which is possible, of achieving any real solution of their difficulties even within the framework of the aid contemplated in this paper, and if there is indeed a need in certain respects for U.S. advice and for a fresh breeze of realism from this side of the water, then the answer lies not in attempting to couple all this with a program of European aid but in the change of relationships which is presaged in the last sentence of the section on Britain and which will be further discussed below.

C. The Principle of Diminishing Shipments

We see in the principle of diminishing shipments the heart of this whole approach to the problem of our aid to Europe. But it should be emphasized that this will be effective only if it is accompanied by a stern and wholly serious warning that the receiving countries bear the further responsibility for seeing that U.S. aid accomplishes its purpose. The inculcation of that feeling of responsibility is vital to the success of this program.

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TOP SECRET

VII. SPECIAL CONSIDERATIONS WITH RESPECT TO CERTAIN
INDIVIDUAL COUNTRIES

A. Great Britain

The British section of this report is necessarily somewhat cryptic. It was prepared on the basis of figures which were made available to us with a reservation that they were "extraordinarily explosive and should be guarded with the greatest secrecy". For this reason, not all of the background of our thinking could be revealed in the wording of the report.

It will be seen that two measures of financial relief are proposed. They are the following: (a) that Britain should be relieved of her portion of the expenditures for Germany, and (b) that as a part of a general European recovery program we take over a portion of the cost of her purchases of consumption commodities, in declining amounts. It was made clear, however, that this might not be sufficient and that further assistance might be needed.

The statistical background of these recommendations is the following.

The drain on Britain's gold and dollar resources is illustrated by the following figures (in millions of dollars):

1946, second half	590
1947, first half	1725
(Present rate of drain, per annum)	3840)
Estimated second half, 1947 . . .	1500
Estimated first half, 1948 . . .	500 - 600
Estimated total, 1947-48	2000 - 2100

It will be seen from this that the drain on British resources is now presumably at its peak. For the coming fiscal year 1947-48 it should run to not much more than two billion dollars. By the end of that period, i.e. about a year hence, to quote from the British report "... we should be well on the way toward total balance ... though on a very low import and consumption standard. But this depends on whether world financial conditions enable us to get paid for our exports."

Now British purchases in the Western Hemisphere are very extensive. For food alone, Britain expects to spend \$1,615,000,000 in this coming fiscal year. If we are to take over this item alone, under the suggestion made in our report, this would, together with the saving on German occupation costs, relieve the British exchange position to the amount of nearly \$2,000,000,000 per annum. This is very close to the prospective deficit of \$2,000,000,000 for the coming fiscal year.

~~TOP SECRET~~

-12-

Why, then, do we envisage the possibility of an additional credit of unspecified amount? The reasons are these:

(a) The aid contemplated in this paper cannot become effective before the beginning of 1948, at the most optimistic estimate. But the bulk of the anticipated drain on British resources for the coming fiscal year, namely \$1,500,000,000 out of \$2,000,000,000 is expected to come in the last half of 1947. By January first 1948 British reserves are expected to be reduced to a point where they could scarcely exceed \$3,000,000,000. This is too low for comfort or for efficiency of operation in an economy which has to trade on so large a scale with other nations; and we consider it bad policy on the part of this country to permit the reserves to remain at that level. We feel that it would hamper the efforts of the British Government to increase production if they were forced to operate on so narrow a margin.

(b) The British estimates assume that British exports will reach a figure of 140 percent of 1938 by the second quarter of 1948. We are not sure that this assumption will be borne out by actual developments. For this reason, again, we think a certain margin is necessary.

~~TOP SECRET~~

(c) A further question mark exists with respect to Britain's continued ability to get paid in dollars by the countries which accept her exports. The British estimates assume that these countries will have dollars with which to pay her. Again, we are not sure about this assumption, nor are the British. The differential involved runs to five or six hundred million dollars. We feel that if we are to be realistic we must also allow for this factor of uncertainty.

The British situation is a very serious one; and there is a large factor of uncertainty in all calculations about Britain's future. We cannot be sure that even the approaches outlined in our paper will produce a state of affairs where Britain will finally be able to exist without constant further aid from this country.

We see in this uncertainty a factor of truly momentous implications. For if Britain cannot really be placed on her feet by means such as those outlined in this report then she would appear to have no future, as an independent nation, except in a dismantling of almost her entire defense and imperial establishment, in attempting to achieve the status of a greater Denmark or Sweden, and in a reduction of living standards and outlook on the part of the British population which would alter

UNCLASSIFIED
TOP SECRET
UNCLASSIFIED

-14-

her entire personality as a political and cultural power.

It is our thought that these eventualities would be highly detrimental to the interests of this country, and that if we were to be faced with this situation it would be, from our standpoint, far better to make a bold and deliberate effort to work out a new pattern of political and economic relationships between the U.K., the U.S., and Canada. This would admittedly be a move in the direction of the concept of "Union Now." But I think we may as well recognize that the logic of history is gradually forcing this concept upon us as a long run development. If Britain cannot adjust herself to her present situation with the aid contemplated in this report, then we will inevitably have to choose between the broad alternatives of abandoning her strategically and politically to the Eurasian land mass, by disinteresting ourselves in her further fate, or of taking her in as an integral part of our own American-Canadian community.

This problem is advancing upon us with formidable speed. By next winter it may be acute. It is not too early to begin getting our people accustomed to looking it in the face. The decision to include in this report the last sentence of the section on Britain was taken

UNCLASSIFIED
TOP SECRET
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deliberately, in full consciousness of the immense scope of its implications.

B. Germany.

Apprehension has been expressed about the section on Germany on the grounds that it may frighten the French and others who are preoccupied with the security aspect of the German problem.

We have made the maximum effort in drafting this section to reassure those who have this preoccupation. But we see no reason for not facing up squarely to the issue right now. To talk about the recovery of Europe and to oppose the recovery of Germany is nonsense.

People can have both or they can have neither.

We can no longer delay in taking measures to relieve ourselves of the high cost of supporting the bi-zonal area. For that reason, energetic steps will have to be taken in any case to revive production there. This can be done with a view to making that area an important contributing element in general European recovery. Or it can be done by trying to make of Germany a self-supporting competitor to the neighboring countries of Europe and abandoning a general program of European aid. This is the real choice for people like the French, and they may as well be brought to recognize it now.

TOP SECRET
UNCLASSIFIED

-16-

The statement about the inadequacy of present arrangements may meet with opposition on the part of people who will say that if only such-and-such measures could be taken by our military government, satisfactory results could be obtained--that it is only a question of policy.

I distrust these calculations and predictions. It seems to me that our expectations as to the effects of our military government policies on German economy have generally tended to be extravagant. Our calculations of indigenous food collections for the year 1946-47 fell short by 250,000 tons. As against planned coal exports of 45,000,000 tons, under the Truman-Attlee-deGaulle plan of 1945, we achieved an actual export of 12,000,000 tons. As against a general export figure of \$375,000,000 for 1947, under the bizonal plan of December 2, 1946, it looks as though we would achieve approximately \$175,000,000. Industrial activity with few exceptions has lagged far behind our expectations.

I am not blaming anyone for these gaps between expectation and fulfillment but I think that they are indicative of a general tendency on our part to overrate our own power to influence the course of German economy.

An economy, after all, consists of people, in this case Germans. I do not think that we can enlist among

TOP SECRET
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the Germans a real will to work and to create under present arrangements. And without that constructive will, I do not think this job can be done.

UNCLASSIFIED
TOP SECRET

-18-

COST OF UNITED STATES AID

It will be noted that the report contained no estimate of the possible costs of U.S. aid under the concepts outlined therein. We felt that it would be premature and unwise to come up with any figure at this time. Any figure we might have mentioned, however tentative and however surrounded with reservations, could not help but be bandied about, and it would soon come to be accepted as an official figure. The Europeans have not yet completed their estimate of what they can do for themselves; and it would be procedurally and psychologically wrong for us to come out now with any estimate of what aid to Europe would cost.

The economic expert of the Planning Staff protested strongly against even any attempt to estimate privately in dollars and cents what an aid program of this nature might conceivably cost. His objections were founded on the flimsiness of the data at our disposal for making such an estimate. He was right, from the standpoint of a conscientious economist.

Nevertheless, I am taking the liberty of submitting the following table of very rough estimates which I have

UNCLASSIFIED
TOP SECRET

made up myself and which I think will give you some idea of the aid which this country might be called upon to give directly to the main exchange deficit countries if the approach outlined in this report were to be adopted. This would cover the efforts which this country would make to supply their needs in consumption goods on a declining scale throughout the period of a European recovery program extending over four years, plus a special credit of one billion dollars to be made available to England during the first year. The table is as follows:

	In millions of dollars				
	1948	1949	1950	1951	Total
Germany	800	700	500	250	2250
Italy	350	275	200	125	950
France	720	540	360	180	1800
Austria	160	120	80	40	400
England	2600	1200	800	400	5000
Greece	150	110	70	30	360
Totals	4780	2945	2010	1025	10,760

These figures represent fairly generous estimates of what these countries might need. To give an idea

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TOP SECRET

-20-

of the sources: the figures on Germany for 1948 and 1949 exceed somewhat General Clay's estimates of what will be needed in the way of supply from outside; the figures on France, Italy and Austria check fairly closely with the estimates of the SWNCC special committee which has made studies on the needs of these countries. The origin of the figures on Britain is indicated above. Mr. McGhee confirms the general adequacy of the figure on Greece.

This table does not take into account such assistance as this Government might be called upon to give to international projects of a capital investment nature. But for these we have the strong hope that the International Bank and other institutions may come to play a part. In addition to that, there is the possibility that the Swiss may help, with their formidable holdings of free exchange. And I believe that the Canadians might find it possible to assume a share of this burden if the whole program showed a plausible chance of success.

As a check on the total, it may be mentioned that Monnet told Mr. Harriman that he estimated the cost of the whole program at ten to twelve billion dollars for the four year period.

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