CHAPTER 1

THIRTY GLORIOUS YEARS

Europe's Mixed Economy

THE FINAL MEETING of the Allied leaders took place in July 1945, in what had once been a palace of the kaiser in the Berlin suburb of Potsdam. Their charge was to plan the last act of World War II and to arrange the peace. One of them was the inexperienced new American president, Harry Truman, who had succeeded Franklin Roosevelt not even three months earlier. The second was the Soviet dictator Joseph Stalin—Uncle Joe, as his allies called him, to his great irritation. It would be many years before the full human cost of his brutal dictatorship and gulags would become known. In the meantime, Soviet central planning, with its five-year plans and massive industrialization, had already cast a spell that was to last for decades more. The third was Winston Churchill, grand strategist and implacable leader, whose bulldog determination when England was all alone had embodied and focused the resistance to Axis aggression. He had indeed been "the hero in history"; it would have been hard to envision an Allied victory without Churchill in those darkest hours of 1940–41.

The stakes at Potsdam were very high, and the agenda was filled with tough and acrimonious issues—the timing of Soviet entry into the war with Japan, the mechanism for the German occupation, reparations—and borders, of course. There was also something else. At one point in the conference, having learned of the successful test of the atomic bomb in the New Mexico desert, Truman walked with studied casualness over to Stalin and told him that the United States had a new weapon. It was very powerful, Truman said. Stalin's reply was no less casual. Good, he said; he hoped that the United States would use it. Truman's revelation was no surprise to the Soviet dictator; he already knew about the American bomb from his spies.

After nine days of diplomatic wrangling, there was an intermission, reflecting what must have seemed to the puzzled Stalin a quaint ritual of bourgeois democracy—an election, in this case a snap British general election, meant to replace the coalition that had governed Britain since May 1940. Churchill departed Potsdam on July 25. Although disturbed by a dream in which he had seen himself dead, he was confident that his Conservative Party would win with a big majority and that he would quickly return to continue the wrangle with Stalin. Instead, the British electorate, fearful of a return to the unemployment and deprivation of the 1930s, delivered a landslide victory to the Labour Party. For the man who had led Britain through its terrible wartime crisis, the defeat was a great humiliation. "Scurvy" was the way Churchill described the outcome. A few weeks later, his wife tried to comfort him about the results. "It may well be a blessing in disguise," she said, to which he replied, "At the moment, it seems quite effectively disguised."

Britain was no longer to be led by this extraordinary figure, once called "the greatest adventurer of modern political history"—descendant of the duke of Marlborough, cavalry officer and Boer War hero, swashbuckler and master prose stylist, liberal reformer-turned-defender of Empire. Instead, he was replaced by Clement Attlee, who—moved by the poverty and despair of Britain's slums and inspired by what he called "Christian ethics"—had spent the first fourteen years of his professional life as a social worker in the East End of London.[1]

The contrast with Churchill was enormous. Described by a contemporary as "so subdued and terse," Attlee, as prime minister, prided himself on not reading newspapers, sought to keep his press briefings to ten minutes or under (punctuated by "Nothing in that" and "That idea seems bonkers to me"), and used the fewest words possible at all times. "Would you say you are an agnostic?" he was asked later in life. "I don't know," he replied. "Is there an afterlife?" "Possibly."

And so it was Attlee, not Churchill, who returned to Potsdam. Although Attlee was a professing socialist, there was little change in the composition of the British delegation, and none in its policies. Nor even in the prime minister's manservant—for, learning that Attlee had no valet, Churchill lent him his own. All of this was totally perplexing to Stalin, who thought there must be a trick. After all, as V. M. Molotov, Stalin's foreign minister, suggested to Attlee, surely Churchill could have "fixed" the results of the election. At Potsdam, Attlee was not at all bothered that trade-union leader Ernest Bevin, his new foreign minister, seemed to do all the talking while Attlee sat silent, wreathed in pipe smoke, nodding his head. "You don't keep a dog and bark yourself," he explained, "and Ernie was a very good dog."[2]

With victory in the war close, Attlee and his Labour colleagues—a contentious mix of Oxford intellectuals, trade unionists, and coal miners—had touched a deep chord in the electorate that Churchill could not. And the programs they would launch represented the beginning of an era in which governments—the "state"—sought to scale and control the commanding heights of their national economies. This happened first in the industrial countries, in the name of reconstruction, economic growth, full employment, and justice and equity, and then later also in the developing world—in the name of progress, nation building and anti-imperialism. The Labourites established and legitimized the model of the "mixed economy"—characterized by strong, direct government involvement in the economy—whether through fiscal management or through a state-owned sector that coexisted with the private sector—plus an expansive welfare state. That model lasted for four decades. The efforts of this Labour band marked the beginning of an economic and political tide that flowed around the world until it reached its peak in the 1970s.

Toward the Mixed Economy

Throughout Western Europe, several broad forces shaped the mixed-economy consensus. The first was before everybody's eyes—the appalling destruction, misery, and disruption created by the war. That devastation precipitated a crisis of unprecedented proportions; never had there been a cataclysm like it. The scene, U.S. secretary of war Henry Stimson wrote in his diary, was "worse than anything probably that ever happened in the world." Tens of millions of people were desperately short of food, many of them on the edge of starvation. The crisis could be measured by the human cost—the dead and the injured, the grim survivors, the flood of displaced persons, the shredding of families. It was also evident in the physical destruction—the homes and factories reduced to rubble, agriculture and transportation disrupted. But there was also a devastation that was less obvious to the eye: Machinery was obsolete and worn-out; the labor force in Europe was exhausted, malnourished, and in disarray; technical skills had been dissipated. Extreme weather, culminating in the Siberian winter of 1947, unleashed a grave crisis.

Something had to be done—and fast. The misery was enormous. If relief did not come quickly, it was feared that communism might well capture the entire continent. There was no functioning private sector to which to turn in order to mobilize the investment, capital goods, and skills necessary for reconstruction and recovery; international trade and payments had been disrupted. Governments would have to fill the vacuum and take charge. They would be the organizers and champions of recovery. There was nothing else.

The policies and programs of the mixed economy also emerged in response to the experiences of the immediately preceding decades. First and foremost was the Great Depression of the 1930s and the mass unemployment that was its most striking manifestation. What happened over the subsequent four decades—and where the world economy stands today—cannot be understood without grasping that unemployment was the central structural problem toward which all policies were to be geared. During the 1920s, the market system had not performed anywhere near adequately in many countries, and during the 1930s, it had failed massively. It could not be counted on not to fail again. Governments, therefore, would take on a much-expanded role in order to deliver full employment, extirpate the "slump," regulate and stabilize economic activity, and ensure that the war was not followed by a depression that would make vain all the promises and idealism and sacrifices of the struggle that had just concluded.

At the end of the war, in Europe and throughout much of the world, capitalism was discredited in a way that is not easily imagined today. It seemed infirm, inept, and incapable. It could not be counted upon to deliver economic growth and a decent life. "Nobody in Europe believes in the American way of life—that is, in private enterprise," the British historian A. J. P. Taylor wrote at the time. "Or rather those who believe in it are a defeated party and a party which seems to have no more future than the Jacobites in England after 1688." Capitalism was considered morally objectionable; it appealed to greed instead of idealism, it promoted inequality, it had failed the people, and—to many—it had been responsible for the war.

One other factor was at work as well. The Soviet Union enjoyed an economic prestige and respect in the West that is hard to reconstruct today. Its five-year plans for industrial development, its "command-and-control" economy, its claims of full employment were all seen to constitute a great oasis and antidote to the unemployment and failures of capitalism in the 1930s. The Soviet economic model gained further credit from the USSR's successful resistance against the Nazi war machine. Altogether, these things gave socialism a good name. This respect and admiration came not only from the left in Europe but also from moderates, and even from conservatives. The anguish and brutality of the Stalinist system were not yet very visible, or were not taken very seriously. The limitations and rigidity of central planning—and, ultimately, its fatal flaw, its inability to innovate—were still decades away from being evident. The historian E. H. Carr, although always sympathetic to the Soviet "experiment," was only exaggerating when he wrote in 1947, "Certainly, if 'we are all planners now,' this is largely the result, conscious or unconscious, of the impact of Soviet practice and Soviet achievement." The Soviet model was the rallying point for the left. It challenged and haunted social democrats, centrists, and conservatives; its imprint on thinking across the entire political spectrum could not be denied.[3]

Britain: Making Good on the Promise

For the Labourites in Britain, the specter of unemployment was the starting point, virtually their raison d'être. They wanted to make good, at last, on Prime Minister David Lloyd George's promise at the end of the First World War of "homes fit for heroes," a promise that had been betrayed in the bitter interwar years. The 1920s, and even more the 1930s, had delivered mass unemployment and hardship, bitter confrontation between labor and management, and preservation of the class system, whereby accent and education (or want of it) denied opportunity and doomed one to staying put. As the Labourites saw it, Britain was a nation whose capitalists had surely failed it; they had underinvested and demonstrated no entrepreneurial drive. Instead, flinty and mean-spirited businessmen had hoarded profits, eschewing new technologies, avoiding innovation, and depriving their workers. These businessmen were hardly the ones to rejuvenate the economy.

The reaction of the Labourites to the 1930s and its unemployment was in fact the culmination of an intellectual movement that had begun during the last decades of the nineteenth century, in response to the poverty and slums spawned by industrialization and to the economic crises and busts of the business cycle. These were the conditions that had led Clement Attlee to stake his career in the East End of London instead of in his father's law chambers. And the response of those who, like Attlee, were appalled by poverty took the form, in varying degrees, of a commitment to reform and social justice, a search for efficiency, a growing belief in the responsibility of government toward its citizens, and an embrace of the British brand of socialism. Much of this was articulated by the Fabians, launched in the late nineteenth century by, among others, Beatrice and Sidney Webb and George Bernard Shaw. This immensely influential society of intellectuals sought to replace the "scramble for private gain" with the achievement of "Collective Welfare"—moving, in Shaw's words, step by step, toward "Collectivism" and "an installment of Socialism." Their method was incrementalism, not revolution.

During the 1930s, the British socialists looked around the world and saw other governments that were "doing things." One model was the optimistic activism, experimentation, and interventionist reforms of Franklin Roosevelt and the New Deal. Others were drawn more to the Soviet Union and what were viewed as the "heroic" accomplishments of communism, socialism, and central planning, which seemed to make the USSR the exception to global stagnation. A segment of the British intelligentsia, led by the Webbs, maintained its romance with Soviet communism for all too long. The Soviet model often impressed the intellectuals more than the trade unionists. Such leaders as Ernest Bevin had become fiercely anticommunist as a result of their battles with the Communists for control of the British union movement, and they proved to be among the most resolute opponents to Soviet expansionism after World War II.

War itself had vastly enlarged the economic realm of government. The management of the British economy during World War II provided positive proof of what government could do, and demonstrated the benefits of planning. Indeed, the government took over the economy and ran it far more efficiently, on a much larger scale, than had been the case in the 1930s; the government could squeeze much more production out of the industrial machine than its capitalist owners had done before the war. Moreover, the population rallied together and shared the experience of the "stress of total war," turning the national economy into a common cause rather than an arena of class conflict. Even the royal family had ration books.

All of these historical currents led to a rejection of Adam Smith, laissez-faire, and traditional nineteenth-century liberalism as an economic philosophy. In the immediate postwar years, there was skepticism and outright disbelief in the idea that the individual's pursuit of what Adam Smith defined as self-interest would add up, in the aggregate, to the benefit of "all." No, the sum was injustice and inequality, the few benefiting from the sweat of the many. The concept of profit was itself morally distasteful. As Attlee put the matter, a belief in private profit as motive for economic progress was "a pathetic faith resting on no foundation of experience."

The Labour politicians who took power in the final weeks of World War II were determined to build what they called "the New Jerusalem." To do so, they would apply the lessons of history and transform the role of government. Building on wartime experiences and institutions, they would make government into the protector and partner of the people and take on responsibility for the well-being of its citizens to a far greater extent than had been the case before the war. Moreover, Labour had the blueprint at hand. It was in the Beveridge Report, prepared by a government-appointed commission during World War II under William Beveridge, a sometime civil servant who had been head of the London School of Economics. The report set out social programs to slay the "five giants": Want, Disease, Ignorance, Squalor, and Idleness (i.e., unemployment). The report, published by His Majesty's Stationer's Office, was a phenomenal best-seller. (Two commentaries on the report, both marked SECRET, were even found in Hitler's bunker at war's end.) The report's influence would be global and far-reaching, forever changing the way not only Britain but also the entire industrialized world came to view the obligations of the state vis-à-vis social welfare.

Implementing the recommendations of the Beveridge Report, the Labour government established free medical care under a newly constituted National Health Service, created new systems of pensions, promoted better education and housing, and sought to deliver on the explicit commitment to "full employment." All of this added up to what the Labourites were to call the welfare state—and they were very proud to do so. The term emerged—as used, for instance, by the archbishop of York in 1941—in explicit contrast to what were said to be the "power states" of the Continental dictators. To be sure, it was on the Continent that national insurance for pensions and illness had been pioneered—by German chancellor Otto von Bismarck, as early as the 1880s. In Britain, the reforming Liberal government of 1906 introduced the first state insurance schemes for unemployment and health and old-age pensions. These initial steps of what was at the time called the "ambulance state" were quite modest. By contrast, the comprehensiveness of the Labour Program of 1945 transformed Britain from a would-be ambulance state into the first major welfare state.[4]

Conquering the Commanding Heights

In 1918, the Labour Party had adopted a constitution containing what became the famous Clause IV, which, in language written by Sidney Webb, called for "common ownership of the means of production, distribution, and exchange." But what were these words to mean in practical terms? The answer came during World War II. One evening in 1944, a retired railway worker named Will Cannon, drawn back into the workforce to help in the marshaling yard, happened to drop by a local union meeting in Reading, not far from London. In the course of the meeting he decided to propose a motion calling for "nationalization," which was approved by the local. The motion won national attention, and the Labour Party ended up adopting it in December 1944. Will Cannon's motion would have a powerful global echo.

In July 1945, Labour came into power totally committed to nationalization and determined to conquer the "commanding heights" of the economy, having borrowed the term from Lenin by the mid-1930s. In their quest for control of the commanding heights after World War II, the Labourites nationalized the fragmented coal industry, which provided 90 percent of Britain's energy at the time. They did the same to iron and steel, railroads, utilities, and international telecommunications. There was some precedent for this even in the British system; after all, it was Winston Churchill himself who, as first lord of the Admiralty in 1911, had purchased a controlling government stake in what became British Petroleum in order to ensure oil supply for the Royal Navy. Churchill's rationale had been security, military power, and the Anglo-German naval race.

The premise of nationalization in the 1940s was quite different—that as private businesses, these industries had underinvested, been inefficient, and lacked scale.* As nationalized firms, they would mobilize resources and adapt new technologies, they would be far more efficient, and they would ensure the achievement of the national objectives of economic development and growth, full employment, and justice and equality. They would be the engine of the overall economy, drawing it toward modernization and greater redistribution of income. These nationalizations were carried out quickly by the Labour minister Herbert Morrison, who in the 1930s had honed his expertise by uniting the buses and Underground of London into one authority.

But exactly how was nationalization to be implemented? The British, after some debate, rejected the "Post Office Model"—nationalized enterprises as departments or adjuncts of government ministries. They opted instead for the "public corporation"—the model already used for the BBC—and what later became known around the world as the state-owned corporation.

---

* These had also been the themes of the more direct forerunners, the nationalizations of electric power in the 1920s—the Central Electricity Generating Board—and of overseas aviation in 1939—the British Overseas Airways Corporation.

Government would appoint a board, which in turn would govern the corporation. Morrison explained: "These are going to be public corporations, business concerns; they will buy the necessary brains and technical skills and give them their heads." But how were the activities of the public corporations to be coordinated in order to fulfill the Labour agenda? The answer was a resounding appeal to "planning." The word had permeated Labour's 1945 election manifesto; and initially at least, Labour's drive to the commanding heights would rally around the concept of planning as the key to the potential promise of nationalization. And nationalization itself was the new grand strategy that, as Attlee put it, represented "the embodiment of our socialist principle of placing the welfare of the nation before any section."

As it turned out, about 20 percent of the nation's workforce ended up employed in the newly nationalized industries. But these were the industries that for the most part made up the "strategic sectors" on which the nation's economy was built. There were limits, however, as to how far the government could or would go. Policy flexibility was limited at the war's end by the stark fact that Britain was, for all practical purposes, bankrupt. Its balance of payments was in desperate shape as the consequence of the government's having spent an enormous amount of the country's national wealth defeating the Axis, and of having lost so much of its invisible earnings from the forced liquidation of its overseas investments. The severity of Britain's penury became apparent in 1946, when a general economic crisis began. Bankruptcy was now compounded by a calamitous winter and the overall breakdown of international trade and payments. Even the elevators in the Treasury were not working, owing to electricity cuts.[5]

"We Work Things Out Practically"

This crisis, accentuated by the emerging cold war, effectively ended further campaigns to capture any more of the commanding heights. Labour's hands were tied. And thus much of the Labourite rhetoric was never implemented. Despite all the discussions about the grand objective of "planning," not a great deal was actually done, and in due course, it was jettisoned. Ernest Bevin, who had helped direct Britain's wartime command economy, dismissed France's postwar commitment to planning with a wave of his hand: "We don't do things like that in our country; we don't have plans, we work things out practically." The shift was facilitated in 1947, when Attlee transferred the reins of control over the nationalized industries from Herbert Morrison to Sir Stafford Cripps. Though Cripps was a rather efficient, pragmatic manager, his self-righteousness earned him Churchill's growl that "there, but for the grace of God, goes God." Cripps was also a firm and vocal advocate of a more moderate approach, and his accession to the number-one position represented a clear abandonment of the attempt to centrally plan British industry.

Certainly, the travails continued. Food rationing remained until 1954.

Babies were registered at birth as vegetarians so that their parents could get eggs for them; rabbit was the only meat that was not controlled. Even candy remained rationed until 1953. Yet despite hard times, the Attlee government had delivered the goods. The British people had acquired a welfare state, which gave them access to health care and better education and greater peace of mind in the face of the vicissitudes of illness, handicap, bad luck, and old age.

And the number-one giant—the one that, more than anything else, had called the Labourites to battle—was slain. Unemployment in Britain during the 1930s had run at 12 percent; in the late 1940s, it was as low as 1.3 percent. Britain had succeeded in replacing the gold standard, which had been the bedrock of orthodoxy and policy in the 1920s and 1930s, with a "full employment standard." The economy was to be judged not by how many troy ounces there were to the British pound but by the number of jobs it could deliver to a population willing to work.

Members of the Labour Party called themselves socialists. But it was a British brand of socialism that owed much more to the nineteenth-century utopian Robert Owen than to Karl Marx. On the eve of taking power, Attlee defined it thus: "a mixed economy developing toward socialism. . . . The doctrines of abundance, of full employment, and of social security require the transfer to public ownership of certain major economic forces and the planned control in the public interest of many other economic activities." And this "mixed economy," with its welfare state, became the basis of what has variously been called the postwar settlement and the Attlee Consensus. Whatever its name, it would have a profound impact around the world over the next four decades.[6]

France: "The Levers of Command"

In France, the great expansion of the state's role arose out of the disaster of the war. France had experienced neither victory nor defeat but rather collapse and humiliation, collaboration and resistance. Coming out of the war, the nation focused on renewal and the restoration of legitimacy. The old order of the Third Republic could not be reestablished; it had failed. In France at war's end, no less than in Britain, the capitalist system was seen as "rotten." It was held to be backward, narrow-minded, retarded by insufficient investment and a "freezing of the capitalist spirit." The villains were rigid family firms and staid businessmen who, lacking in entrepreneurship, had sought to protect themselves from competition, preserve the family's position, and avoid "creative risk." In fact, the system was already discredited on the eve of World War II. In 1939, the average age of France's industrial machinery was four times that of America and three times that of Britain, while output per working hour in France was one third that in America and one half that in Britain. There had been no improvement in the standard of living since before the Great War;

per capita income in 1939 was the same as in 1913. The experience of the Second World War accentuated the critique of capitalism in three ways: France's backward economic organization was a mighty cause of its military and political weakness; the old system was inadequate to meet the overriding needs of reconstruction; and a significant part of French business was deeply tainted by its leaders' collaboration with the Nazis and the puppet Vichy regime.

Across much of the political spectrum, there was consensus on the need to expand government in the face of the apparent weakness of the market system. "The state," General Charles de Gaulle, new head of the provisional government, declared in 1945, "must hold the levers of command." This would be something quite different from what had prevailed before the war. He told the "privileged classes" that they were dismissed because they had "disqualified themselves." There was to be a new France, economically vigorous, built upon an economy divided into three sectors: the private, the controlled, and the nationalized. Nationalization would serve multiple purposes: It would promote investment, modernization, and technological progress; it would solve the problem of monopoly; and it would consolidate and rationalize fragmented industries, some of which were highly fractionated (some 1,730 firms were fully engaged in the production, transmission, and distribution of electricity; another 970 firms were partly engaged in the same enterprise). It would punish the collaborators by taking their firms away from them and turning them over to the "people." Nationalization would also perform one other very critical service: It would enroll the Communist-controlled unions in the process of reconstruction rather than leave them outside to wage war on it.

Some precedent for nationalization existed. In the 1920s, for instance, France had created a state oil company, Compagnie Française des Pétroles, to protect and expand French interests and become "the industrial arms of government action." It was the type of firm that would come to be called a "national champion"—a company, either state-owned or closely aligned to the government, that would represent national interests domestically and in international competition—and, as such, would receive preferences from the government. The nationalization of the railroads in 1937 had been a large-scale bailout of that badly bleeding industry. For the most part, however, nationalization and an active state role had not been part of the French tradition. That changed with the Liberation. Through the nationalization acts of 1945 and 1946, the French state decisively asserted its dominion over the commanding heights, taking control of banking, electricity, gas, and coal, among other industries. The state also undertook punitive nationalizations of companies whose owners and managers had consorted with Vichy, including Renault and several important media concerns. By the end of this wave, the French economy had been transformed.

But as quickly as nationalization was implemented, the process was no less quickly halted by 1947. The form of corporate governance adopted in France gave board members from Communist-controlled unions inordinate influence over the newly nationalized industries; and the zeal with which they abused this power to pursue their own agenda generated a sharp response. Statutory reforms and a change in political alliances finally wrested control from the Communists, but there was little taste left for further nationalization. The Communists left the coalition government in May 1947 in the midst of the emerging cold war and, on Moscow's orders, went on the offensive against the state with massive strikes. By 1950, the communist leader who had been minister of industrial production during the nationalization phase was declaring his opposition. Nationalization was "a capitalist weapon," he said, for propping up the capitalist state and resisting the communist tide. Yet when it was all added up, France too had become a mixed economy. The state had acquired a major stake in some of the most critical sectors of the economy, in what was a very decisive break with the prewar tradition.[7]

The Cognac Salesman

The response to the challenge of reconstruction was also to be found in another form of expansion of the state's power over the economy—through *"planification,"* the implementation of a national economic plan that became France's postwar trademark. This process—focusing, prioritizing, and pointing the way—was dubbed indicative planning, to differentiate it from the Soviet system, with its highly directive and rigid central planning. It was very much intended to be a middle way between free markets and socialism.

How appropriate that this plan for a middle way would be developed by a capitalist banker who voted socialist. His name was Jean Monnet, and although he never held high office, he was one of the most influential figures of the entire postwar era. He is best remembered as the "Father of Europe"—the creator and instigator of what is now the European Union. But first he fathered the plan that shook the French economy out of its stalemate and propelled it into the modern age.

Monnet was a citizen of the world who could, when needed, behave like an obstinate French peasant buying or selling a cow. He was driven by drink, so to speak, to his internationalism. Born into a brandy family from Cognac, he left school at sixteen to travel the world selling the liquor—from isolated farms on the prairies of western Canada to villages along the Nile in Egypt. It is said that he ended up, along the way, with a bigger vocabulary in English than in French. On one of his Canadian trips, having traveled from Medicine Hat to Moose Jaw, he found himself in Calgary, looking for a horse and buggy. He asked a stranger for the nearest stable. "Take my horse," the stranger replied. "When you're through just hitch it up here." That, Monnet later said, was his first introduction to the international pooling of resources. During World War I, he played a key role in organizing the Allied supply effort. He also began building up an extraordinary network of friendships on both sides of the Atlantic, which would serve him well in later years. At the Versailles conference, for instance, he met John Foster Dulles (later U.S. secretary of state). Monnet went out of his way to maintain that relationship thereafter, since, he explained, "nothing important is done in the United States without lawyers." In 1919, at age thirty-one, he was appointed deputy secretary-general of the new League of Nations. After two frustrating years, he quit, returned to the family business, fixed its troubled finances, and then gave up cognac altogether in favor of international banking. So extensive and far-flung were Monnet's connections, and so hard did he work them to such productive purpose, that he probably should also be remembered, in today's parlance, as the father of networking.

But it was an urgent matter of the heart that truly demonstrated his unique combination of wits, willpower, persistence, connections, and creativity. In 1929, Monnet fell hopelessly in love with an Italian woman, a painter named Silvia di Bondini. She was not only a devout Catholic but was also already married and had a daughter. Divorce—with child custody—was frustrated at every turn. Even Reno, Nevada, could not meet their needs. It took Monnet five years to find the solution. In 1934, he was traveling aboard the trans-Siberian railway on his way back from a banking mission in China. Monnet disembarked in Moscow. His beloved was there to meet him. Using his connections, Monnet had her made a Soviet citizen in a matter of days and she was immediately divorced. Wasting no time, they married right there in Moscow. Monnet quickly caught a train to Paris, where he deposited his new wife, moved on to New York—and then back to Shanghai to resume his work reorganizing the Chinese railways. He was certainly not a man to stand still. But the marriage lasted forty-five years.

During World War II, Monnet once again operated at the highest levels, serving as supply and reconstruction coordinator for the French government-in-exile as well as economic liaison to the United States. He organized the flow of urgently needed supplies and finance and facilitated overall economic policy among the Allies. He had easy access to Roosevelt's inner circle. (Forever after, de Gaulle suspected him of being an American agent.) He came up with the phrase that the United States should become the "arsenal of democracy," for which Roosevelt's advisers heartily thanked him. They also promptly told him never to use it again so that FDR could reserve the historic phrase for himself.[8]

The Plan: "Modernization or Decadence"?

Monnet, perhaps more clearly than any other Frenchman, grasped the magnitude of the war's destruction and the overwhelming requirements of reconstruction that would confront France afterward. The country was burdened with an industrial engine that had been sputtering for decades even before the war, and France's immediate postwar economic agenda would be dominated both by a huge balance-of-payments crisis and the fundamental need to modernize. The government would have to deal with the first, and the private sector could not be depended upon for the second. Out of these necessities emerged the Monnet Plan.

The more immediate origin of this plan was a conversation Monnet had with de Gaulle in Washington, D.C., in August 1945, a few weeks after the end of the war. "You speak of greatness," Monnet said, "but today the French are small. There will only be greatness when the French are of a stature to warrant it. . . . For this purpose, they must modernize—because at the moment they are not modern. Materially, the country needs to be transformed."

"You are certainly right," replied de Gaulle. Impressed by the vitality and prosperity he saw around him in America, the general turned the problem back to Monnet: "Do you want to try?"

Monnet certainly did. He set up shop at first in Paris in a few rooms in the Bristol Hotel, putting a board across the bathtub to create extra office space, and then moved to a town house that had belonged to Cézanne's art dealer, close to the prime minister's office. There, with minimal staff and maximum behind-the-scenes maneuvering, he drew up the first plan aimed at restoring normal economic life to France.

Essentially, what the Monnet Plan did was prioritize, set investment targets, and allocate investment funds, with the focus on reconstruction, particularly in the basic industries—defined by Monnet as the nationalized electricity, coal, and rail transportation industries, and the nonnationalized steel, cement, and agricultural machinery industries. For Monnet, the importance of the targets lay not in reaching a scientifically optimal level of investment. Rather, establishing an optimistic, forward-looking plan was an end in itself. He wanted action that would generate more action. Initiating momentum would prevent the economy from falling back into its prewar risk-averse ways and again "crystallizing at a low level."

The French also needed a plan as a prospectus for obtaining American aid. The U.S. undersecretary of state for economic affairs, Will Clayton, one of the authors of the Marshall Plan, made this point explicitly, privately exhorting French officials to "be liberals or *dirigistes*. Return to capitalism or head toward socialism. . . . But in either case the government must . . . formulate a precise program proving its desire to give France an economy that will permit it to reach international production costs calculated in man-hours. If it . . . demonstrates to us the seriousness of its program, we shall help your country, for its prosperity is necessary to peace." Thus a feasible plan was essential to secure the aid that eventually flowed into France through the Marshall Plan. Monnet also succeeded in insulating the planning function from the vagaries of French politics. He carried out a brilliant administrative coup by establishing the planning board, the Commissariat Général du Plan, as an independent commission reporting directly to the prime minister.[9]

The formulation of the plan required all of Monnet's formidable skills—as planner, coordinator, financier, and networker. The result was a masterpiece: a plan on which France could hang its hopes, a basis on which the United States could provide aid, and a mechanism by which the French economy could receive the support and restructuring denied it for so many decades by its pessimistic capitalists. Yet the results were somewhat mixed. Some targets were made, others were missed. By 1950, only the coal mines had exceeded the original construction and modernization programs. France also missed its overall investment targets, the growth in its industrial output was well below that of its neighbors, and the aggressive investment program contributed to inflation. But what the plan did do, at a crucial period, was provide the discipline, direction, vision, confidence, and hope for a nation that otherwise might have remained in a deep and dangerous malaise. And it set France on the road to an economic miracle in the 1950s.

Monnet had developed a great love for balance sheets as a boy while poring over the accounts of the family brandy business with his father, and his plan was hailed at the time as "the first attempt in postwar Europe to draw up a balance sheet and overall program for the future." Yet Monnet was not necessarily enamored of central planning. As one future prime minister remarked, "The odd thing is he did not like plans." Monnet did not take a stand one way or the other on nationalization, and he may well have preferred markets, large, open markets to grand plans. But he seized upon the state's monopoly, even if only temporary, over both capital and credit, because he saw no good alternative.

"Modernization or decadence"—that was the choice that Monnet, with his plan, posed for France. In seeking to ensure that the choice was modernization, he expanded the role of government in the national economy and created one of the most credible models for that role, and for planning. And by so doing, Monnet's biographer wrote, "he helped create a relative consensus behind . . . the 'mixed economy' "—and not only for France, but for Europe.[10]

Germany: Lucky Strikes and "Chicken Feed"

Nowhere else in Europe was capitalism so discredited as in the four occupied zones of postwar Germany, owing to the complicity of a good part of big business with Hitler. The Nazis had organized and administered a "warfare state" that had preserved private property but controlled and subordinated it to their own purposes. The SPD—the Social Democrats—was the only party with a record of fighting the Nazis from the first day to the last, and it intended to create a noncapitalist future.

The appalling conditions of postwar life seemed to provide the circumstances for implementing a socialist vision. Germany was a devastated, desperately hungry country. Controls and rationing contributed to a barter economy, with dejected people trooping, by dilapidated trains, to the countryside to exchange whatever household goods they might still possess for a couple of eggs or a bag of potatoes. So pervasive were the black and gray markets that, it was estimated, only half of the country's meager output passed through legal channels. The official currency was almost worthless—one-five-hundredth of its original value. The working currency of the country was not the reichsmark but cartons of Lucky Strike cigarettes, favored by American GIs. Conditions were so deplorable that the Catholic archbishop of Cologne told his faithful it was all right to steal food and coal in order to survive. The mayor of Cologne, Konrad Adenauer, slept in his suit and coat, owing to the lack of heat. His driver managed to do better, sleeping in a bathtub in a hospital bathroom, where at least it was warmer.

Surely in such conditions the new Germany was destined to become a socialist country. The Social Democrats were led by Kurt Schumacher, who had spent ten years in Nazi concentration camps, eight of them in Dachau. Now, in postwar Germany, he and his party were committed to replacing capitalism with nationalization and central planning, much in line with the policies of the British Labour Party. That certainly seemed to be the direction the country would take. Even the center-right Christian Democrats adopted a program in 1947 which declared that "the capitalist economic system" had failed "the national and social interests of the German people" and instead called for public ownership of the commanding heights and a "considerable" degree of central planning "for a long time to come."

Yet within a year Germany was to set off on quite a different economic path. There were a number of reasons. Soviet expansionism was fueling a confrontation between East and West that would lead to the division of Germany and discredit the left wing. Marshall Plan aid was beginning to lay the basis for an integrated European economy. And then there was the matter of the chicken feed.

The food situation in Germany was awful. The average number of daily calories consumed was 1,300, and sometimes as low as 800, just a quarter of the prewar level. "We do not see why you have to read *The New York Times* to know that the Germans are close to starving," General Lucius Clay, the head of the U.S. military occupation, had angrily cabled Washington. "The crisis is now." The German shortfall was part of a global food crisis; European wheat production in 1947 was half of what it had been in 1938. In response, the United States started pouring a great deal of food relief into Germany. Then, in January 1948, Johannes Semler, the German director of economic administration for Bizonia (as the combined American and British occupation zones were called) made a speech in which he complained that much of the grain that the Americans were sending was not wheat but rather corn, which, he sarcastically pointed out, was what Germans fed to chickens, not to people. The word he used—*Hühnerfutter*—was translated as "chicken feed." That was hardly a gracious way to describe free food aid. The furious General Clay fired Semler. As his replacement, Clay chose a rotund economist named Ludwig Erhard, who had been economic minister of Bavaria for several months after the war. Denied an academic appointment during the Hitler years because of his refusal to join a Nazi organization, he had spent his time quietly doing market research in Nuremberg. Now, suddenly and unexpectedly, he was in a position to lead Germany to an economic future different from what would have been assumed even a year earlier.[11]

The Ordoliberals and the Social Market

Ludwig Erhard belonged to an economic group that called itself the Ordoliberals. Some of its members were centered around the University of Freiburg and thus were sometimes called the Freiburg School. It included such figures as Alfred Müller-Armack, Wilhelm Röpke, Walter Eucken, and Alexander Rüstow. They were committed to free markets, and believed that the disaster of Nazism was the culmination of cartelization and state control over the economy. The Ordoliberals also believed that they had identified the answer to the deeply painful question "of how Nazi totalitarianism could have risen in the country of Kant, Goethe, and Beethoven." The explanation was to be found in the latter part of the nineteenth century, when cartels and monopolies developed unchecked by the state in the new German Reich, leading to greater and greater concentrations of economic and political power and, ultimately, to totalitarianism. Market forces and a competitive economy were the standard for the Ordoliberals. Government's responsibility was to create and maintain a framework that promoted competition and prevented cartels. Competition was the best way to prevent private or public concentrations of power, thus constituting the best guarantee of political liberty, as well as providing a superior economic mechanism.

Yet the Ordoliberals' vision was not simply laissez-faire. The "Ordo" captured their sense of order—"a certain hierarchy or 'natural form' of society"—deliberately meant to be linked to the medieval idea of natural order. They believed in a strong state and a strong social morality. As Wilhelm Röpke explained it: "We want no restriction of the market economy of competition and of the freely floating price mechanism. Nor do we want a mixed economy. . . . We also well know that if we seek a pure free market economy based on competition, it cannot float freely in a social, political, and moral vacuum, but must be maintained and protected by a strong social, political, and moral framework. Justice, the state, traditions and morals, firm standards and values . . . are part of this framework as are the economic, social, and fiscal policies which, outside the market sphere, balance interests, protect the weak, restrain the immoderate, cut down excesses, limit power, set the rules of the game and guard their observance."

Thus, to the Ordoliberals there was nothing inconsistent between their commitment to free markets and their support of a social safety net—a system of subsidies and transfer payments to take care of the weak and disadvantaged. All this added up to what they were to call the "social market economy." The term was invented by Alfred Müller-Armack, one of Ludwig Erhard's senior advisers, and it came to describe the German economic model in the postwar years. In their version, the state might do a great deal. What it was not to do, however, was interfere with the market mechanism by fixing prices or controlling output. Like many other Germans, the Ordo-liberals also saw the root of so much of Germany's misfortune in the hyperinflation of the post–World War I years that had alienated and virtually wiped out the German middle class, undermining the basis of democracy. Thus they were devoted to a stable currency, a devotion that would later come to be the raison d'être of Germany's central bank, the Bundesbank.[12]

Erhard: "Pay No Attention"

The Ordoliberals' principles guided Erhard. "Our people will be truly fortunate," he wrote not long before becoming economics director, "if we can realize an economic order that makes room for free economic activity that is cognizant of its social responsibility instead of the prevailing and universally detested bureaucratic formalism." Now that unfortunate reference to "chicken feed" had put him in the position to act on those principles and put Ordoliberalism into practice.

Events provided support. Soviet obstruction and territorial ambitions led the Western allies to give up on four-power cooperation and instead to shape a western Germany that would be tied to Western Europe. This coincided with the recognition that Europe could not recover with a destitute Germany at its heart. The last vestiges of the United States' 1944 Morgenthau Plan, which called for the "pastoralization" of Germany, were allowed to fade away. Instead, a revived Germany, its industry rejuvenated, was to be integrated with its neighbors through the Marshall Plan.

The seminal events took place in June 1948. The Americans and British executed a massive overnight currency reform, replacing worthless reichsmarks with new deutsche marks, which created a sound economic foundation. Currency reform was essential if the occupation zones were to be fused politically. Not involved in its implementation, Erhard was angry when he found out about it from General Clay only a few hours in advance. He retaliated by jumping the gun and announcing it, as though he had played a key role, on his weekly radio talk show.

Of no less significance was the step toward a liberal economic order that Erhard took a few days later, this time on his own authority. Germany was still gripped by a massive system of allocations and price controls inherited from the Nazis. Now it was Erhard's opportunity to fully turn the tables on Clay. No alterations could be made in the system of price controls without the Allies' approval. But there was no requirement for approval of complete abolition of the system, since no one thought it could possibly be done. That is exactly what Erhard did, simply abolishing most of the price controls overnight, without a word in advance to Clay.

Suddenly, Germany had a functioning economy again. The black and gray markets disappeared; goods reappeared in shop windows. It was Clay's turn to be nonplussed. "Herr Erhard," he said. "My advisers tell me that what you have done is a terrible mistake. What do you say to that?"

"Herr General, pay no attention to them!" Erhard replied. "My own advisers tell me the same thing."

Clay did not disagree. The historians of postwar Germany would describe this meeting as "the 'most fateful' event in the history of postwar Germany"—the beginning of the economic miracle and the launching of the social market economy.

A few days later, on June 23, the Soviets imposed the Berlin blockade in order to stop the currency reform and frustrate efforts to consolidate the three Western occupation zones. They laid siege to Berlin, which, although ninety miles inside the Communist zone, was under four-power occupation. By severing all rail and road transport, they aimed to choke off all supplies to the city until the Western powers caved in on the currency and political unification. The Soviets, however, had not counted on the massive airlift of supplies that the Western allies hurriedly improvised. Had the Russians interfered with that, they would have risked starting World War III. The blockade did further damage to the Soviet position by having quite the opposite effect from what was intended. In April 1949, the North Atlantic Treaty, establishing NATO, was signed, and the blockade only served to speed up the transformation of the three Western occupation zones into a new, unified, Western-oriented democratic state. With the strong support of the Western allies, the Germans promulgated the Basic Law, establishing the Federal Republic (as West Germany was officially known) on May 8, 1949, four years to the day after Nazi Germany's surrender. The Soviets, realizing that they had played their hand badly, called off the blockade.[13]

The Wirtschaftswunder

Thus was created a potential political context for the social market economy. But would the context be there? That depended upon the outcome of the campaign for the Bundestag, the new parliament, and the choice of the first postwar chancellor. And it seemed likely that victory would go to Kurt Schumacher's Social Democrats, with their quite different notions of how the economy should be run. Pitted against Schumacher was Konrad Adenauer, the Catholic liberal who had been mayor of Cologne from 1917 until he was fired in 1933 for refusing to fly Nazi flags over the city hall when Hitler visited Cologne. He spent the Nazi years partly tending his roses, partly in prison, and partly in hiding. He was imprisoned for the final time in 1944, after the German officers' failed assassination attempt against Hitler, initially in a concentration camp and then in a Gestapo prison. "If the advance of the American army had not taken place so surprisingly near us," he wrote a friend in the United States one day after Hitler's suicide, "I probably would have been taken away and killed by the Gestapo." For a time after World War II, he was again mayor of Cologne. No one could doubt his anti-Nazi record; his wife died in 1948 as a consequence of her imprisonment in a Gestapo jail.

The September 1949 election was fought very much, as Adenauer was to say, over the "planned economy" versus the "social market economy." The results were inconclusive, as Schumacher's Social Democrats and Adenauer's Christian Democratic/Christian Socialist parties each received about 30 percent of the vote, with the rest going to a variety of other parties. The choice of chancellor would be decided in the Bundestag. And critical to the outcome would be the votes of the small Free Democratic Party, the one true free-market party in Germany. It threw its support to Adenauer. He was elected by just one vote—his own. "My doctor tells me," the seventy-three-year-old chancellor announced, "that I would be able to carry out this office for at least a year, perhaps for two." As it turned out, he stayed fourteen years. For the entire time, Ludwig Erhard was his economics minister, responsible for building the social market economy. The result was to be the *Wirtschaftswunder*—the German economic miracle.

To be sure, the social market economy looked in many ways like a mixed economy. In 1969, for instance, the federal government owned one fourth or more of the shares of some 650 companies. Public ownership at the federal *Länder* (state) and the local levels was relatively broad in its scope, including transportation systems, telephone, telegraph, postal communications, radio and television networks, and utilities. Partial public ownership extended to coal, iron, steel, shipbuilding, and other manufacturing activities. But there were crucial differences between the German formulation of industrial policy and the French and British models. In France and England, the state took control of the commanding heights so that it could provide prosperity for all. In Germany, the state created—and to a limited extent took control of—a network of organizations around the commanding heights so that the market could work more effectively. The economy operated under the tripartite management of government, business, and labor. The unique nature of this corporatist system was embodied in the supervisory boards, *Betriebsräte,* which consisted of numbers of representatives from all three sectors. This uniquely German formulation, under the aegis of Adenauer and Erhard, propelled Germany from its economic nadir in 1947 to the center of the European economic order in under a decade and firmly established it as the locomotive of European economic growth.[14]

Italy: The National Champion

Postwar Italy did not develop a mixed economy; it inherited one from the Fascist government of Benito Mussolini. In 1933, in the midst of the global slump, the Fascists created IRI—Istituto per la Ricostruzione Industriale—to keep bankrupt companies afloat by extending credit and, in the process, acquiring them. In due course, IRI came to control not only the three largest banks but a significant part of the country's industrial base. "By 1936, the initial phase of the most 'unplanned' nationalization of industry in the Western world" was completed. Thereafter, the Fascists did find a plan—to put IRI to work in an industrial policy meant to strengthen Italy's war-making capabilities. After the war, successively weak governments were unable to assert their authority over IRI, and its various managers ran the component companies to their own liking. IRI was less a tool to capture the future than the continuation of a cozy past. Without centralized control, industrial policy amounted to an amalgamation of the particular strategies of the various parts of IRI.

The decisive break with this IRI past, however, came with a new state-owned enterprise, the oil company ENI—Ente Nazionale Idrocarburi. It was fashioned in the immediate postwar years out of AGIP, a state-owned refining company created as a national champion in the 1920s. That ENI achieved its place as a driver of the Italian economy was the work of one man, Enrico Mattei, the unruly son of a policeman from northern Italy. Mattei, who had dropped out of school at age fourteen, ended up running a chemical company and then emerged as a partisan leader during the war. His managerial and political skills won him the top position at AGIP after the war, and he set about creating a giant new company, dominant in Italy and competitive with the existing large oil companies—what he called the "seven sisters." By the 1950s, ENI was a sprawling conglomerate of some thirty-six companies; their businesses ranged from crude oil and gasoline stations to hotels, toll highways, and soaps.

The president or managing director of every one of the subsidiaries was one and the same man, Enrico Mattei. "For the first time in the economic history of Italy," the American embassy reported in 1954, a government-owned entity in Italy "has found itself in the unique position of being financially solvent, capably led, and responsible to no one other than its leader"—a man, the report added, of "limitless ambition." Mattei was also a man of great magnetism. "Anybody who worked with him would go into the fire for him," one of his aides would later recall, "although you couldn't really explain why."

What could be explained was how potent a symbol the state-owned ENI became. Indeed, it embodied what was so powerful about the postwar state-owned national champion. Enrico Mattei expressed the vision for postwar Italy: antifascism, the resurrection and rebuilding of the nation, and the emergence of the "new man," who had made it himself, without the old-boy network of the IRI crowd or the Fascist past. The company facilitated reconstruction; it promised to deliver natural resources to a resource-poor country. It appealed to national pride. Mattei knew how to capture the imagination of the public. Only a few years after the war, ENI was already building new gasoline stations along Italy's roads and autostradas that were larger, more attractive, and more commodious than those of its international competitors. They even had restaurants.

No private concern in Italy could have done what ENI did, and ENI could not have become what it did, had it not been for the disorganization that characterized the Italian state's precarious hold on the economy's commanding heights. ENI had access to the resources of the state, and it used them to build up what became the eighth-largest oil company in the world. It also generated the human capital and the opportunity for generations of technically trained and commercially adept Italians to become world-class oilmen. ENI not only fueled Italy's economic miracle, it became a major engine of that growth. In symbolic terms, it put fascism into the past and helped shape Italy's postwar future. ENI became a model for what state-owned companies could achieve—and for the very rationale for state ownership. That rationale could be summed up in two words—*growth* and *progress*.[15]

"The Encroachment" of John Maynard Keynes

As the period of reconstruction came to an end and the first signs of prosperity began to appear, management of the mixed economy came to rest on the intellectual foundations of a compelling new economics. It was derived not from socialism but from the work of a reformer of capitalism, John Maynard Keynes, the most influential economist of the twentieth century. Keynes was a product of the late Victorian and Edwardian eras, a period when stability, prosperity, and peace were assumed and when Britain ruled the world economy. Keynes never lost the self-confidence, self-assurance, and indeed the optimism of that time. But his intellectual career, and his profound impact, arose from his efforts to make sense of the disruptions and crises that began with the First World War and continued through the Great Depression.

Descended from a knight who had crossed the English Channel with William the Conqueror, Keynes was the son of a Cambridge University economist. Educated at Eton and Cambridge, he demonstrated from his early years a dazzling, wide-ranging intellect, along with an arrogance and what seemed to some a dismissive elitism. His establishment habits (including the signature homburg normally associated with a City of London stockbroker) and his pride in being a member of what he called the *"educated* bourgeoisie" were combined with chronic social and intellectual rebellion, orneriness, and the lifestyle of a Bloomsbury bohemian and aesthete. His daunting mathematical dexterity was complemented by a considerable literary grace, whether the subject was the subtleties of economic thought or his obsession with the hands of statesmen. He celebrated "vigilant observation" of the real world as one of the requirements of a good economist, and he loved to pore through statistics. His best ideas, he liked to say, came "from messing about with figures and *seeing* what they must mean." Nevertheless, he could not resist endlessly toying with ideas, and he compulsively sought to spin out all-encompassing theories and generalizations from particulars.

As an economic adviser to the British delegation at the Versailles conference in 1919, he became convinced that the Carthaginian peace that the Allies were imposing on Germany would undermine European economic recovery and guarantee new crises. Disgusted, he resigned and retired to the English countryside, where, in a matter of weeks, he brought together his searing criticisms in *The Economic Consequences of the Peace.* That book made him famous. In the 1920s, he focused mostly on monetary issues. He lambasted the decision by Winston Churchill, at the time chancellor of the exchequer, to return Britain to the gold standard with an overvalued pound in a work entitled *The Economic Consequences of Mr. Churchill.*

During those years and into the 1930s, he split his week between King's College in Cambridge, where he did his teaching, and London, where he busied himself speculating in currencies, commodities, and stocks. He was also on the board of a number of investment and insurance companies, and in fact served as the chairman of one. He was a master of markets and their psychology. As bursar of King's College—during the Great Depression—he increased the college's endowment tenfold. He also made himself very wealthy managing his own portfolio, despite periodic reverses. He did not hesitate to take risks. "The academic economist," said a close friend of Keynes, "never really knows what makes a businessman tick, why he wants sometimes to gamble on an investment project and why he sometimes prefers liquidity and cash. Maynard understood because he was a gambler himself and felt the gambling or liquidity instincts of the businessman." As Keynes himself once explained, "Business life is always a bet." [16]

Persistent unemployment in Britain, and then the mass unemployment of the Great Depression, redirected Keynes' intellectual agenda from monetary affairs to unemployment and led to his most influential work, *The General Theory of Employment, Interest and Money,* published in 1936. Here was Keynes as vigilant observer, keen mathematician, self-confident rebel, and grand generalizer. The book constituted a vast assault on the classical economics tradition in which he had been raised. The era that had nurtured classical economics had been destroyed by the First World War, and for Keynes the cataclysms since had demonstrated the tradition's inadequacies. A new synthesis was necessary, and that is what Keynes, working with his "kindergarten" of disciples in Cambridge, sought to create.

In particular, he concluded that classical economics rested on a fundamental error. It assumed, mistakenly, that the balance between supply and demand would ensure full employment. On the contrary, in Keynes' view, the economy was chronically unstable and subject to fluctuations, and supply and demand could well balance out at an equilibrium that did not deliver full employment. The reasons were inadequate investment and oversaving, both rooted in the psychology of uncertainty.

The solution to this conundrum was seemingly simple: Replace the missing private investment with public investment, financed by deliberate deficits. The government would borrow money to spend on such things as public works; and that deficit spending, in turn, would create jobs and increase purchasing power. Striving to balance the government's budget during a slump would make things worse, not better. In order to make his argument, Keynes deployed a range of new tools—standardized national income accounting (which led to the basic concept of gross national product), the concept of aggregate demand, and the multiplier (people receiving government money for public-works jobs will spend money, which will create new jobs). Keynes' analysis laid the basis for the field of macroeconomics, which treats the economy as a whole and focuses on government's use of fiscal policy—spending, deficits, and tax. These tools could be used to manage aggregate demand and thus ensure full employment. As a corollary, the government would cut back its spending during times of recovery and expansion. This last precept, however, was all too often forgotten or overlooked.

Keynes intended government to play a much larger role in the economy. His vision was one of reformed capitalism, managed capitalism—capitalism saved both from socialism and from itself. He talked about a "somewhat comprehensive socialization of investment" and the state's taking "an ever greater responsibility for directly organizing investment." Fiscal policy would enable wise managers to stabilize the economy without resorting to actual controls. The bulk of decision making would remain with the decentralized market rather than with the central planner.

Keynes had worked on *The General Theory* with feverish intensity, convinced that new apocalypses were waiting close in the wings even as the world struggled with the Depression. The alternative to reform was totalitarianism. And it was not only the new vistas of macroeconomics but also the dangers of the time that helped explain the fervor with which others embraced the argument. As one of his students explained, "Finally what Keynes supplied was *hope:* hope that prosperity could be restored and maintained without the support of prison camps, executions, and bestial interrogations."

A new apocalypse came soon enough. With the outbreak of World War II, Keynes moved on to the questions of how to finance the war and then how to develop a postwar currency system. He was one of the fathers of the Bretton Woods accord, which established the World Bank and the International Monetary Fund, and which put in place a system of fixed exchange rates. He also returned to a subject that had obsessed him since the First World War—how to cope with, and limit, Britain's submission to America's financial might. After all, he had come to maturity in an age when Britain ruled the international economy. Now, however distastefully, he struggled to adjust Britain to the new reality of American ascendancy. His last major enterprise was to negotiate a multibillion-dollar U.S. loan for Britain in 1946. It was a very nasty business. The stress literally killed him.

Keynes provided both a specific rationale for government's taking a bigger role in the economy and a more general confidence in the ability of government to intervene and manage effectively. As Keynes' work turned into "Keynesianism" in the post–World War II years, the self-confidence that had animated its author continued to be at its root. Despite Keynes' fascination with uncertainty and his speculative talents in the marketplace, Keynesians deemed "government knowledge" to be superior to that of the marketplace. In the words of Keynes' biographer Robert Skidelsky, the unstated message in its most extreme form was this: "The state is wise and the market is stupid."

In one of the most famous passages of *The General Theory,* Keynes had written, "The power of vested interests is vastly exaggerated compared with the gradual encroachment of ideas." There was nothing gradual, however, in the encroachment of Keynesianism or in its conquest of the commanding heights of economic thinking. Within a few years of his death, it was already taking a dominant place in economic policy making both in Britain and in the United States. How far-reaching its impact, or at least the perception of its impact, was demonstrated by a history of economic thought published in the mid-1960s: "In most Western economies Keynesian theory has laid the intellectual foundations for a managed and welfare-oriented form of capitalism. Indeed, the widespread absorption of the Keynesian message has in large measure been responsible for the generally high levels of employment achieved by most Western industrial countries since the Second World War and for a significant reorientation in attitudes toward the role of the state in economic life." Keynes' self-confidence lived on in his thought.[17]

Trade and National Power

The common acceptance of Keynesianism and the other principles of the mixed economy helped draw the European countries together, despite their many differences, in the three decades after the war. The commonality saw its ultimate expression in what today is known as the European Union.

Jean Monnet first seized upon the potential for securing Europe's future through interdependence. During World War II, he was already envisioning a modern Lotharingia—as the middle of three kingdoms created by Charlemagne's grandsons had been called a thousand years earlier. But Monnet's vision was not a historical dream. It was the response to very practical problems—what to do about Germany and how to prevent another European war. The overarching answer: Integrate a revived, productive Germany into a united Europe. Lotharingia would be the first step. The coal and steel–producing regions at the borders of France and Germany—in Alsace-Lorraine and in the Ruhr—that had been the source of so much conflict would be internationally administered under what was called the Schuman Plan. It was so named for the French foreign minister Robert Schuman, but in fact it was largely the work of Jean Monnet. In the phrase of the time, it "launched" Europe. But the launch was much bolstered by the Marshall Plan, which had insisted that the Europeans draw up a common plan for disbursement of American aid. The Marshall Plan also provided a "code of liberalization" to reduce trade barriers among the European countries in order to facilitate the most efficient use of aid.

The next step came in 1957. Spurred by Monnet's vision and shocked by the dramatic events of autumn 1956—the Suez Crisis, which split the Western alliance, and the Soviet suppression of the Hungarian revolution—the nations of Europe "relaunched Europe" by signing the Treaty of Rome. It established the Common Market, otherwise known as the European Economic Community—an unprecedented joining of diverse economies, built upon three bonds—the mixed-economy consensus, the drive to solve the German question, and the threat from the Soviet Bloc.

Thus, even as the governments of the Western European nations were assuming more responsibility for their national economies, they were also—with the launching of European integration—taking the first steps toward ceding national control by reducing obstacles to trade and investment. In so doing, Europe was part of a larger process of lowering trade barriers and expanding international trade that would serve as the counterpoint to national power.

During World War II, American and British officials had taken the lead in negotiating a comprehensive and unprecedented new system to facilitate and promote international trade. They knew exactly what they wanted to escape from—the fractured interwar trading system, with its quantitative barriers, high tariffs, preferential agreements, blockages, managed trade, and "beggar thy neighbor" policies. Such ferocious protectionism, they were convinced, had contributed mightily to the global slump and the political problems that came with it, and to the ensuing war. Their dream was to recover the open trading system of the late nineteenth century, which had stimulated global growth. They had a foundation on which to build—the reciprocal trade agreements that U.S. secretary of state Cordell Hull, a very traditional nineteenth-century liberal, had championed in the 1930s. But the new system they negotiated during the war, in contrast to Hull's, was to be based upon multilateralism, meaning that many countries would simultaneously accede to reductions in trade barriers. This new system was to be embodied in the International Trade Organization (ITO), which was meant to provide both the framework for multilateral trade negotiations and the mechanisms to design and implement the required rules. It was meant to be the third leg of the postwar international economic tripod, along with the World Bank and the International Monetary Fund.

In 1947, at a conference in Havana, fifty-seven countries concluded negotiations on a treaty establishing the ITO. As it turned out, however, there was little popular or congressional support for the ITO, and much opposition. In 1950, several months after the outbreak of the Korean War, the State Department issued a press release dryly announcing that the plan for the ITO was now in abeyance. Protectionists in Congress thought they had won. "The State Department have written the obituary but I was in charge of the funeral," one senator jubilantly declared. But the protectionists were wrong. President Truman had the executive authority to implement the provisions of a stopgap measure that was part of the ITO negotiations—the General Agreement on Tariffs and Trade (GATT). Administered through periodic meetings, this agreement was the mechanism for negotiating multilateral reductions in trade barriers and for working out rules for world trade.

The GATT did not have the formality or the powers of the ITO. Yet, put into effect in 1948, it became the framework through which the barriers to international trade—whether in goods, services, or finance—were progressively lowered over the next half century. The GATT would become one of the most important propellants of postwar economic growth and would help create a global economy that transcended the borders of individual countries, opening the commanding heights to international competition and eroding the power of the nation-state.[18]

"You Never Had It So Good"

All that, however, was still many years off. At the time, there were more immediate sources of economic recovery. The Korean War, 1950–53, and the military buildup that went with it, provided a major stimulus to growth throughout the industrial world; and thereafter, defense spending continued to be a major driver of growth. There was also continuing anxiety in the West about what were thought to be the economic achievements and high growth rates of the Soviet Union, and as to whether East or West would win the economic race—and who would capture the economic allegiance of what Churchill had dubbed the third world. The Soviet launching of the first satellite, *Sputnik,* in 1957, was not only a dramatic jolt; it also seemed to confirm the vigor of the Soviet-style command economy.

Yet the economic record of the Western European countries in the postwar years was extraordinary. The mixed economy delivered a standard of living and a way of life that could not have been anticipated, or even imagined, at the end of World War II. The 1950s and 1960s became known as the golden age of the welfare state in Britain. "Most of our people have never had it so good," Prime Minister Harold Macmillan replied to a heckler at a political rally on a soccer field in 1957. And "You never had it so good" became his very accurate campaign slogan.

It was true right across Western Europe. For the first time, workers could begin to buy the products of their own labor. In France, the strikes and the threat of a communist takeover receded into memory. This period in France became known as *Les Trente Glorieuses*—"the thirty glorious years." Germany, powered by its social market economy, became the country of the "economic miracle"—*Wirtschaftswunder*—as the country moved toward Ludwig Erhard's goal of "prosperity for all." Both were growing at 5 or 6 percent a year, or even more. By 1955, all the Western European countries had exceeded their prewar levels of production. The scourge of unemployment, which discredited the prewar order throughout the industrial world and which had been the number-one stimulus to action, was banished. In France, average unemployment between 1945 and 1969 was 1.3 percent. In Germany, unemployment dropped to the virtually invisible 0.5 percent in 1970.

This record of success in the industrial countries of Europe vindicated the idea that government must take an active role in overseeing or directing the economy—and in many cases own part of it—in order to provide prosperity for all. On the strength of this unprecedented economic expansion, the mixed economy established itself as the new incumbent system and one whose reach would grow in the ensuing years. The state was either in control of the commanding heights or managing the levers of fiscal policy. Government had created and assumed the responsibilities of the welfare state, and it was dedicated to correcting the "failures" of the market. All this added up to a formula for economic success that consigned the deplorable interwar years and the destruction of World War II to the past. By any comparison, these were, indeed, in economic terms, the glorious years.[19]