15 Recovery and reconstruction: Europe after the Second World War

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The world war that began 80 years ago when the German armoured divisions crossed the Oder – and ended with a surrender act aboard a warship in Tokyo Bay – was the worst of all wars, 'the War of the World' that brought the 'descent of the West' (Ferguson 2006).

The struggle of Nazi Germany and Imperial Japan for global supremacy exhausted the human and economic resources of much of Europe as well as East and Southeast Asia (Boldorf and Okazaki 2015). The six years of carnage incinerated 60 million souls, among them six million Jews. The majority of the military casualties were citizens of the Soviet Union, China, Germany, and Japan, but the dead were mourned the world over (Weinberg 2005). Tens of millions more were displaced and haunted by the oppressions of war, men wearing the scars of battle and women scarred by the humiliation of abuse at the hands of the enemy or their own husbands returning from the torments of frontline service. After the war had ended in Europe, 12 million Germans were held as Allied prisoners of war, two million of them never to return home. Millions of children across the continent would grow up without a father.

The enormous firepower of industrial warfare and aerial bombardment 'brought physical destruction that few could have imagined and few imagined could be overcome in their lifetime' (Vonyó 2018). That a Europe more prosperous than ever would emerge from this apocalypse astonished the world. Most economies shattered by war returned to pre-war levels of output within five years. The quarter-century that followed would be engraved in collective memory as the most remarkable era of macroeconomic stability and social progress in the history of the western world (Milward 1992) and as the 'golden age of economic growth' in Europe, both East and West (Crafts 2018).

Western Europe: Foundations of recovery

There is consensus in the more recent historiography of the post-war era that the foundations of economic life remained strong. Across Western Europe, the casualties of war were more than offset by natural population growth and post-war mass migration. Despite the scale of material damage, industrial equipment and plants survived the war remarkably intact. Even in Germany and Italy, the two main targets of Allied strategic bombing, industrial fixed capital grew by 20% and 30%, respectively, between 1936 and 1945. Power-generating capacity was also enlarged and needed little repair.

Industrial production had been brought to a halt by the demolition of the transport infrastructure, in particular bridges and railway hubs. But the maintenance of wartime command-economy controls and warlike labour mobilisation swiftly eliminated these bottlenecks and avoided the acute shortages that might have fuelled social unrest and runaway inflation, as Europe had experienced at the end of the First World War (Boltho 2001). By 1947, industrial production was back at pre-war levels in at least the victorious powers and the non-belligerent economies.

Continued revival and the resumption of economic growth were held back by institutional and geopolitical factors rather than the lack of productive capacity. The reconstruction of Western Europe required the abolition of the command economy and the liberalisation of prices and wages; the elimination of the dollar shortage to enable countries ravaged by war to import the capital goods necessary to rebuild their infrastructure and restock their factories; the restoration of the European division of labour; and international cooperation to resolve the German question and remobilise German industry (Milward 1987, Eichengreen 2007).

These prerequisites were impossible to achieve without American leadership in the rebuilding of the post-war order (Maier 1981). Recent scholarship has found the positive impact of the Marshall Plan not so much in the scale of material assistance, but rather in the political strings attached to it (Eichengreen 2007). Dollar aid enabled recipient nations to eliminate raw material shortages and invest in bottleneck industries, but only in exchange for trade liberalisation. The resources afforded by the counterpart funds allowed governments to finance public investment projects without the need to cut back on welfare spending, but they were compelled to reintroduce free markets and lift wartime controls and rationing, despite fierce opposition from labour unions.

Perhaps most crucially, the Marshall Plan, passed in 1948, underpinned post-war political stability by marginalising communist parties and supporting centrist governments, by forging a western alliance to contain Soviet expansionism, and by rehabilitating West Germany on the international stage. Indeed, it demonstrated a dramatic shift in

Allied policy towards German economic recovery, which until 1947 was inhibiting, and it offered sufficient compensation for the leading claimants on German reparations: France and the Benelux states.

The centrality of Germany

Germany was defeated and divided, but the rebuilding of Germany was necessary for the economic revival of Europe. West Germany alone remained the largest market and the prime exporter of capital goods on the continent. It was the precise aim of the Marshall Plan to mobilise German industrial might for European reconstruction.

It was the most momentous task, for the war and the post-war settlement had dislocated the German economy in more ways than one. The air war destroyed much of the urban housing stock. This left millions trapped in the rural hinterlands without the prospect of finding employment and left urban industry with a crashing labour shortage (Vonyó 2012). The miserable living conditions and the rigidities of Allied occupation prevented the return to normal economic life.

Price controls began to ease and markets revive following the currency reform of 1948 but restrictions on imports remained in place for another year and on production in strategic industries and the merchant navy for even longer. The division of Germany untied input–output links between western and eastern industrial districts and left severe structural imbalances in manufacturing capacity on both sides of the Iron Curtain.

These dislocating forces were primarily responsible for the disappointing productivity performance of German industry and also for the falling behind of the East German economy in the post-war years (Ritschl and Vonyó 2014). East Germany inherited highly specialised industrial districts, which were now cut off from both their major suppliers of intermediary inputs and their largest market. What followed was an exodus of both skilled labour and thousands of small and medium-sized firms. Economic reconstruction in West Germany lasted throughout the 1950s and propelled the Wirtschaftswunder (Vonyó 2018), while the damage the division on Germany had caused in the East was irreparable.

Reconstruction was a driving force behind the growth miracles of post-war Europe, including the other defeated powers, Austria and Italy, as well as Greece and Spain, both ravaged by civil war. The role of reconstruction growth in the early post-war period was confirmed econometrically by Dumke (1990) and Temin (2002), but more recent investigations demonstrated that its impact did not vanish until the end of the golden age (Vonyó 2008, 2017).

These novel findings also revealed that the falling behind of Eastern Europe in the post-war era was not so much the consequence of socialism as the result of comparatively modest levels of investment and weak reconstruction dynamics (Vonyó 2017). Both, in turn, can be best explained by the differential impact of the war and the post-war settlement on population growth, which deprived Eastern Europe of the flexible labour supply that has long been recognised as instrumental in western reconstruction and structural modernisation (Kindleberger 1967).

Eastern Europe: A demographic disaster

The brutality of the Eastern Front in World War II was apocalyptic and brought unprecedented destruction. The most devastating campaigns in global military history were fought over the 'bloodlands' stretching between Berlin and Stalingrad (Snyder 2010). Thousands of towns and villages were removed from the face of the earth; tens of millions were made homeless.

The human toll was incomparable to any other region of the world. Forty million Eastern Europeans died in the carnage, including more than five of the six million European Jews who perished in the Holocaust. From the invasion of the Soviet Union, Nazi Germany waged a war of extermination. The thirst for vengeance among the oppressed revealed itself in early 1945, when the Red Army rank and file ran amok in the eastern provinces of Germany, although Soviet soldiers often behaved similarly towards the 'liberated', too.

Millions more fled west, either running from the advancing Soviet troops or defecting when the communist parties rose to power in the Eastern regions. The expulsion of ethnic Germans from Central and Eastern Europe after 1945 and forced population exchanges enhanced this exodus. In accordance with Article XIII of the Potsdam Agreement, 15 million Germans were driven from their historical settlements east of the rivers Oder and Neisse, of which approximately nine million had lived in the eastern provinces of Prussia in 1939. One million were deported to the Soviet Union, with another 700,000 forcefully resettled from the European to the Asian territories of the USSR and 13 million expelled to post-war Germany and Austria. Two million were killed or went missing in the course of these deportations (Vonyó 2018).

While these population movements featured prominently in German historiography, their impact was largely ignored in the economic history of Eastern Europe. The effect of war casualties, including those physically or psychologically disabled, combined with the post-war settlement, was devastating. The populations of Hungary, Romania, and Yugoslavia stagnated between 1939 and 1950. Czechoslovakia, Poland, and the

Soviet Union each suffered population declines of 10–20% over the same period. Czechoslovakia and Poland did not recover from this demographic shock until the 1960s. The shortage of labour, and especially of skills, was crushing. The eastern provinces of Prussia, ceded to Poland and the USSR in 1945, and the Sudetenland were temporarily depopulated and their industrial districts lost most of their pre-war labour force.

Across Central and Eastern Europe, the war left behind a distorted demographic structure with a crippling shortage of able-bodied young men, who had traditionally constituted the backbone of the industrial workforce. The Holocaust and the expulsion of ethnic Germans, together with the mass voluntary exodus of the bourgeois middle class, bequeathed upon the tormented region a plethora of industrial and commercial enterprises without their original owners and the necessary skills and managerial know-how required to operate them.

The economic performance of the eastern half of Europe after 1945 can only be evaluated in light of these inauspicious beginnings. While communism and the command economy played their part, they are not the whole story. The initial conditions of economic recovery in Eastern Europe were also far less favourable than in the West.

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