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The 'Koreaboom' in West Germany: fact or fiction?[1]

By PETER TEMIN

It has become something of a cottage industry to provide advice for the troubled economies of eastern Europe by drawing historical lessons out of previous economic transitions. The aftermath of both world wars has been called into play in this endeavour. The horrifying consequences of the First World War have been used to provide pessimistic lessons, while the more benign events following the Second have been examined for more hopeful signs.

Dornbusch's account of the monetary consequences of the break-up of the Austro-Hungarian empire provides an example of the former choice.[2] He emphasized the length of time—about five years—it took to stabilize the currencies in the former empire once the Austrian crown was no longer the universal currency. The latter choice is illustrated by a set of essays on the European recovery after the Second World War drawing lessons for eastern Europe in chapters both from the story of the international organizations created in the late 1940s and from national experiences.[3]

The general tone of accounts of the reconstruction of Europe after the Second World War is self-congratulatory. Historians typically argue that we learned from the disastrous experience of the interwar years and acted in an enlightened fashion. This Whig interpretation fits with our sense of technological progress. Progress is cumulative; we do not have to reinvent the steam engine in every generation.

There are, however, some flies in this Whig ideological ointment. There are examples in which technical knowledge has been lost. The Japanese used gunpowder in the fifteenth century and then, for complex reasons, abandoned it and had lost the ability to use it by the time of Admiral Perry.[4] And what is a rarity in technological history unhappily is more common in political history. Even today, policy makers dealing with both eastern and western Europe do not seem to have learned much from the past century of economic turbulence.[5] This pessimistic note is echoed in the frequent references to the Korean War in narratives of the reconstruction of West Germany after the Second World War. In many accounts of the postwar German economy, notably those by Abelshauser and Giersch, the West German miracle was in some trouble, perhaps even foundering, in

[1] I thank the World Economy Laboratory at the MIT Department of Economics for financial support and Hans-Joachim Voth for helpful comments. All errors, of course, are mine.

[2] Dornbusch, 'Monetary problems of post-communism'.

[3] Eichengreen, ed., *Europe's postwar growth, revisited.*

[4] Perrin, *Giving up the gun.*

[5] Feinstein, Temin, and Toniolo, 'Three shocks, two recoveries?'.

1950. It was rescued by a *deus ex machina*, an exogenous positive demand shock coming from the unexpected outbreak of hostilities in Korea.

The underlying issue is whether economic policy in postwar Europe was skilful or simply lucky. It has become fashionable to denigrate the initiatives undertaken at that time. The Marshall Plan was too small or too late to have much effect; the IMF, GATT, and ECSC too inactive; and the European Payments Union (EPU) potentially as harmful as beneficial. As the role of these policy initiatives has been diminished, other positive influences have had to be found. Among them has been the Korean War. If the new war rather than the reconciliatory, peaceful policies of the postwar decade was important, then the lessons from the postwar recovery for eastern Europe today are considerably less sanguine than most of us would like.

This article will re-examine the shock to the West German economy emanating from the Korean War. It will argue that the boom was in fact mythical. The postwar German recovery was *not* due to fortuitous exogenous shocks, or at least not to this particular shock. Instead successful economic policies kept an adverse shock from developing into the kind of crisis that typified the interwar years. The 'Koreaboom' is thought to have taken place in 1950, immediately following the outbreak of the Korean War on 26 June. However, neither American imports nor German exports rose unusually at that time. Instead, Germany suffered an adverse price shock at the same time as its imports increased. The result was not a boom, but a balance of payments crisis. The fledgling EPU acted swiftly to keep this small problem from escalating into a major economic or political crisis.

I conclude that West Germany did not experience what Giersch and his co-authors called 'a massive Keynesian-type stimulus'.[6] Instead, it received a small negative shock. The policy measures taken in response to this shock show that policy contributed to the recovery. Their importance depends on what one considers to have been the alternative.

I

Abelshauser has played down the importance of the Marshall Plan to West Germany. In its place he asserted that the Korean War provided a different and welcome stimulus. In his words (author's translation):

> The outbreak of the war in Korea in June 1950 pushed foreign demand for German investment goods and raw material, as well as domestic demand for consumption goods, by leaps and bounds to new heights. For the first time the West German economy experienced a growth push from the external economy. It also was advantageous that West Germany was the only important industrial state which had reserve industrial capacity. Industrial production correspondingly picked up steam during 1950.[7]

This view has been reinforced recently by Giersch, Paqué, and Schmieding.

[6] Giersch, Paqué, and Schmieding, 'Openness, wage restraint, and macroeconomic stability', p. 9.

[7] Abelshauser, 'Probleme des Wiederaufbaus der westdeutschen Wirtschaft, 1945-1953', p. 243. See also *idem*, *Wirtschaftsgeschichte der Bundesrepublik Deutschland, 1945-1980*, pp. 67-8.

They refer to 'the fortuitous business upswing which set in with the worldwide Korea boom in early summer 1950'. They continue:

> In a way, the Koreaboom provided the West German economy with a Keynesian stimulus just at a time when it was most needed and popular; as the boost did not come from government spending, all those negative crowding-out effects of an increase in public expenditure on domestic investment could be avoided. The only (modest) price to be paid for the boom was a sharp but temporary hike of imported price inflation and a short-lived—though politically critical—balance-of-payments crisis.[8]

This view has been taken up by other scholars. Kramer argued in an account of the first decade of postwar Germany that, 'the outbreak of the Korean War . . . had greater effect on the West German economy than any measures of economic policy hitherto taken by the German authorities'.[9] And in a new analysis of the German postwar recovery, Wolf described 'the sudden strong demand increase resulting from the Korean War'.[10]

There is an immediately apparent problem with these arguments. Abelshauser spoke of the increase of production in 1950, that is, in the first six months of the war. Giersch *et al.* noted that the cost was felt in a balance of payments crisis. Since this crisis unfolded in the autumn of 1950, Giersch *et al.* clearly also are referring to an expansion during the opening days of the war. The problem is to explain how the outbreak of war on another continent could have an *immediate* effect on the German economy.

This task is only one small part of the longer run question of what generated the German 'miracle'. It can be argued that the Korean War—as a political event—led to the Cold War with consequent United States support for western Europe. Any stimulus from this quarter, however, came well after the 1950 Koreaboom in the literature. This article can be seen as a prologue to the analysis of these developments of the mid-1950s. The West German economy was expanding rapidly at the start of the decade. The question therefore is not whether Germany was having a boom in 1950, but rather whether it was having a 'Koreaboom'. If this was indeed the case, there must have been a connection between the war and the rate of German growth.

II

To examine the effect on West Germany of the outbreak of hostilities, we need to ask how an American war in Asia could help Germany. Assuming there was a Korean War boom in the United States, how could the expansion there help Europe? This is the transfer problem identified in the discussion of German reparations in the 1920s.[11]

There are several possible channels. First, the expansion of American domestic spending could have spilled over into an expansion of imports.

[8] Giersch, Paqué, and Schmieding, *Fading miracle*, p. 62.

[9] Kramer, *West Germany economy*, p. 166.

[10] Wolf, 'The lucky miracle: Germany 1945-1951', reiterated in *idem*, 'Postwar Germany in the European context'.

[11] Keynes, *Economic consequences of the peace*, pp. 187-8; Eichengreen, *Golden fetters*, pp. 131-3.

To the extent that these imports came from West Germany, the effect on that country would be expansionary. Secondly, the focus on military production in the United States could have led to a reduction in US civilian exports, providing a market opportunity for other countries. To the extent that West German suppliers were able to move into this void, Germany would benefit again.[12] It is worth noting that this second channel is indirect; it works through the mediation of third countries. It also clearly takes time to work.

In addition to these quantity effects, there could have been price effects. The war led to temporary shortages and anticipations of further shortages in the United States which led to inflation; it may have caused world prices to rise as well. This third channel, by which expansion in the United States could have affected Germany, may have worked in a different direction from the preceding two. Whether a country gains or loses from a price rise depends on whether the country is an exporter or importer of the goods in question.

Before examining German data to see if these effects were present, we need to deal with a problem. West German data start only in 1950 because the Federal Republic was created only during the previous year. Before then most German data refer to Bizonia, the Bizone created from the union of the American and British zones of occupation. We must ask if the omission of data from the French zone poses a problem.

Table 1. *West German trade by zone, 1948-1950* ($ million)

Year	*Bizone*	*French zone*	*West Germany*	*French share (%)*
Imports				
1948	1,400	179	1,579	11
1949	2,089	149	2,238	7
1950			2,697	
Exports				
1948	592	110	702	16
1949	1,029	89	1,118	8
1950			1,977	

Source: United Nations, Statistical Office, *Yearbook of international trade statistics*, 1951, p. 103

Table 1 contains trade data for 1948 and 1949 from the parts of what would become West Germany. Before then the data are corrupted both by the chaotic monetary situation and by the inclusion of the Saar in the French Zone. Even these two years, fortunately, provide enough of a run to show that the French Zone was not an important factor in West Germany's foreign trade just before Trizonia replaced Bizonia. I therefore ignore the French Zone.[13] Table 1 also shows that German trade was expanding rapidly in the late 1940s. Simple expansion in 1950 or 1951 therefore does not show the presence of a Korean demand shock. It is necessary to show that there

[12] The 'Korean War increased demand for exports from the German and European economies', Heilemann and Jochimsen, *Christmas in July?*, p. 11.

[13] Industrial production in the French Zone moved with that in the Bizone: Milward, *Reconstruction of Western Europe*, p. 356.

was an unusual rise in exports following the outbreak of the conflict in Korea.

Figure 1 shows West German quarterly trade data from January 1949 to the end of 1951. It is clear that exports did not rise suddenly in the second half of 1950 or in 1951. Instead, there is a smooth rise from 1949 through the first three quarters of 1951. The slight bulge in the last quarter of 1950 brings West German exports only marginally above their trend. This strong trend was part of the postwar recovery of Europe, aided in Germany by the 1948 currency reform and the Marshall Plan. West German production and exports were growing rapidly in 1949 and 1950 due to some combination of these stimuli. The task here is not to explain this trend, but rather to ask if there is evidence of an additional stimulus in the summer of 1950.

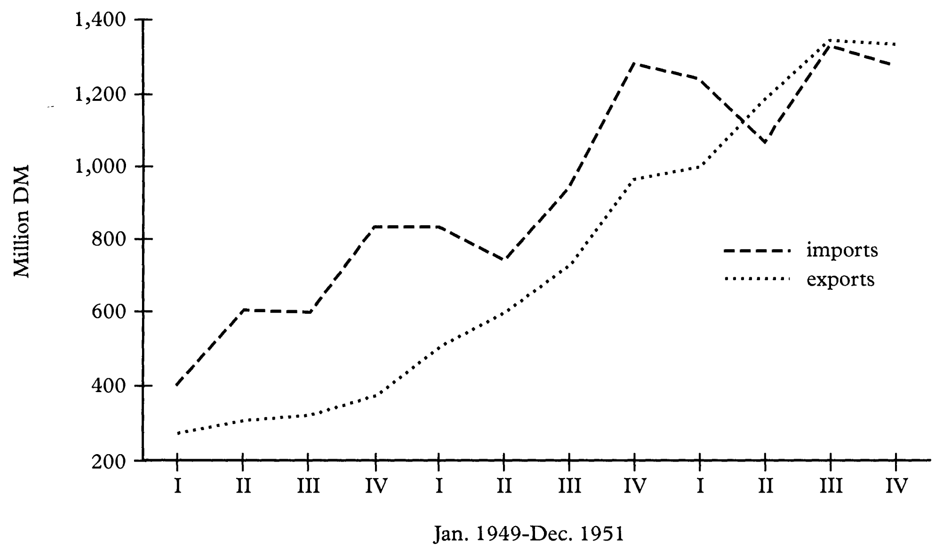

Figure 1. *West Germany: import and export values, 1949-1951*
Source: tab. A1

It is possible that the demand for German exports could have evaporated in late 1950 in the absence of the Korean War, but no one has suggested that it was likely. Western Europe was recovering from the world war and the 1949 recession and currency realignment; the growth of West German exports was an integral part of this recovery.[14] Economic strains noted by the authors cited above were internal to West Germany, not pervasive throughout Europe.

The size of the late 1950 bulge is not large. A simple regression of monthly West German exports on time for the two years starting in October 1949—the period of the unbroken export expansion—gives an R^2 of 0.98. The 'excess' exports, calculated as the residuals from this regression, total 170 million DM in the last quarter of 1950. But this is only 0.2 per cent

[14] Buchheim, *Die Wiedereingliederung Westdeutschlands*; Dumke, 'Reassessing the Wirtschaftswunder'; Milward, *Reconstruction of Western Europe*.

of West German national income, and it is offset by an equally large export 'deficit' in each of the adjacent quarters. Any stimulus from an exogenous rise in the demand for German exports at the start of the Korean War was both tiny and short-lived.

This finding is in opposition to qualitative accounts of this period, although not of the supporting data. The Organization for European Economic Co-operation (OEEC), for example, stated in its fourth annual report in 1952 that, 'The improvement in the current overall balance [of member countries] in the second half of 1950 was essentially due to an abrupt increase in exports, caused mainly by semi-speculative demand which developed in many other countries as well as the United States after the outbreak of the Korean war.' The accompanying table shows data by half-years, and it is clear that the improvement in the current account balance of the OEEC was due to a slower than usual growth in imports, not a bulge in exports. For the OEEC as a whole, as for West Germany, there was no unusual increase in exports in the latter half of 1950.[15]

The upward leap in foreign demand for German goods that Abelshauser argued was such an important feature of 1950 is not in evidence. The simple story of an export demand stimulating a boom without 'all these negative crowding-out effects' (in the words of Giersch *et al.*) is not borne out by the data. To understand this result we have to retrace our steps and look at the effect of the war in a belligerent country: the United States.

III

The United States did have a Korean War boom, albeit a small one. The North Koreans attacked the South unexpectedly on 25 June 1950. The United Nations Command under the direction of the United States came into being in early July, and American military expenditures quickly accelerated. US defence expenditures rose from $14.3 billion in 1950 to $33.8 billion and then $46.2 billion in 1951 and 1952. They stayed at this new level for the rest of the decade. (GNP was about $300 billion in 1950-1.)[16] This was a more rapid rise in military spending relative to GNP than in any single year or pair of years during the Reagan military build-up of the 1980s, although the rise was not sustained for nearly as long as the Reagan military expansion.

The tax policy of the United States under Truman was quite opposite to that of Reagan. While Reagan slashed taxes, Truman raised them. On 25 July 1950, exactly one month after the outbreak of hostilities, Truman requested a $5 billion tax increase from Congress. A few months later, he asked also for an excess profits tax that would raise an additional $4 billion. In fact, the President moved so quickly to contain the demand stimulus of the added military spending that the increased government revenue preceded the increased expenditures.[17] The result was that the real full-employment

[15] Organization for European Economic Co-operation, *Europe—the way ahead*, pp. 40-1.
[16] United States, Council of Economic Advisors, *Economic report of the president, 1992*.
[17] Congressional Quarterly Service, *Congress and the nation, 1945-1964*, pp. 408-11.

government surplus rose sharply during 1950. Military spending began to expand rapidly only in 1951, turning the full-employment surplus into deficit. The deflationary shift in 1950 and the expansionary shift in 1951 were each about 6 per cent of real GNP.[18]

The rapid imposition of higher taxes turned the initial impact of the Korean War in the United States into a deflationary one. Only in the second quarter of 1951 did a fiscal stimulus from the war emerge. This is in sharp contrast to the normal wartime boom when the rise in military expenditures is accompanied by a simultaneous rise in the government deficit. In addition to the two world wars, the Vietnam War followed this more usual pattern.[19]

There was still a noticeable boom in the US. Output rose rapidly, as did prices. The quantity data are shown in table 2. Real output grew rapidly in the US in both 1950 and 1951. But the source of the growth was different in the two years. The rapid growth in 1950 was due to an accelerated rate of consumer durable purchases, not to a direct fiscal stimulus from the government. Only in 1951 did military expenditures—the most volatile part of government expenses in these years—rise dramatically.

Table 2. *Annual rate of growth of US expenditures* (1982 dollars)

Year	*Real GNP*	*Consumer durables expenditures*	*Federal government expenditures*
1948	0.038	0.099	0.141
1949	0.004	0.109	0.107
1950	0.087	0.186	0.041
1951	0.099	−0.072	0.760
1952	0.043	−0.020	0.266
1953	0.037	0.100	0.047
1954	−0.007	0.019	−0.138
1955	0.056	0.186	−0.082

Source: United States, Council of Economic Advisors, *Economic report of the president*, 1992, pp. 288-9

The rapid rise in consumer durable expenditures in 1950 was the product of two influences. There was a modest rise in purchases before the outbreak of the war as part of the recovery from the mild recession of 1949. Once the war began, consumers greatly accelerated their purchases of consumer durables in anticipation—historians have inferred—of wartime shortages resembling those in the world war. Real consumer durable consumption rose by 25 per cent from the second to the third quarter of 1950.[20] This was the initial Korean War boom in the United States.

The boom also had a small but perceptible price component. Consumer and producer prices, which had remained stable in 1948-50, rose by 8 and 9 per cent in 1951. They were stable again thereafter. The Korean War

[18] Full employment in 1950 was taken to be when unemployment was 5%: Gordon, *Macroeconomics*, tab. A-2, p. A5.

[19] United States, Council of Economic Advisors, *Economic report of the president, 1992*.

[20] Gordon, 'Postwar macroeconomics: the evolution of events and ideas', p. 115; Balke and Gordon, 'Historical data', p. 824.

inflation was mild because price controls were instituted and because the demand stimulus was small.[21]

The question here concerns the international effect of the US boom. Figures 2 and 3, which show US import and export values and quantities in 1950 and 1951, provide evidence on the magnitude of the quantity effects.[22] US imports did rise during the first few months of the Korean War, but three aspects of this rise suggest that it did not provide a positive demand shock for other countries. First, the rise continued smoothly the rise that had started in the summer of 1949 with the US economic recovery. Secondly, the rise was far smaller in real terms than in nominal terms—figure 3 as opposed to figure 2—suggesting that the apparent rise may simply have been the product of money illusion. Thirdly, the rise was short-lived, to be replaced by declining imports in the first half of 1951. The rise was a combination of a price rise and a cyclical recovery of imports, not a large exogenous shock to production in other countries.

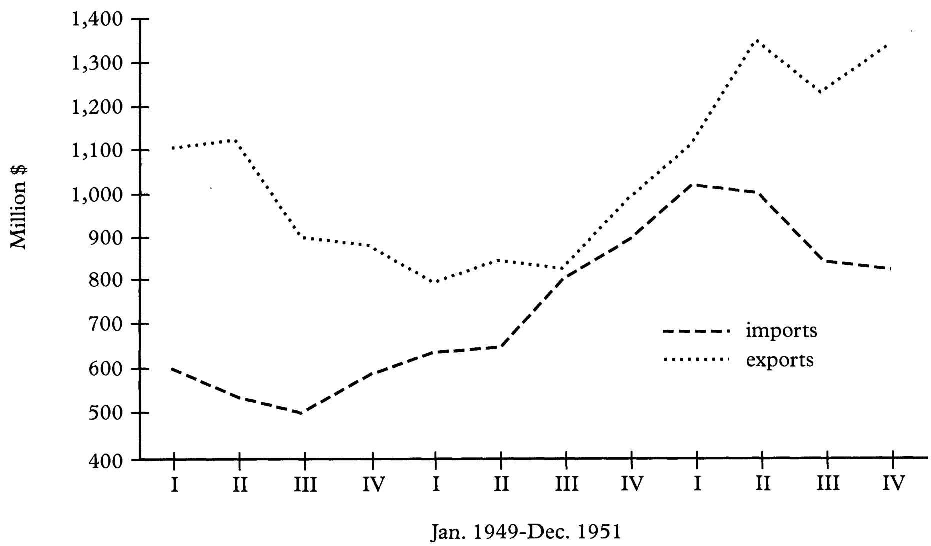

Figure 2. *United States: import and export values, 1949-1951*
Source: tab. A2

Imports, of course, include imports of materials used in the war, both military and non-military. The United States, for example, bought lorries in Japan for use in Korea, providing a welcome boost to the prostrate Japanese vehicle industry. It is unlikely that materials to be used in Asia were purchased in Europe and particularly unlikely that any war-related goods were purchased in Germany. And as noted above, war purchases did not rise until 1951. The first channel by which the Korean War could have stimulated the West German economy in 1950 was not effective.

[21] Data from United States, Council of Economic Advisors, *Economic report of the president, 1992*. Analysis, which indicates that the price movement is not well understood, from Gordon, 'Postwar macroeconomics', p. 119.

[22] The data underlying the figures are shown in tabs. A1 and A2.

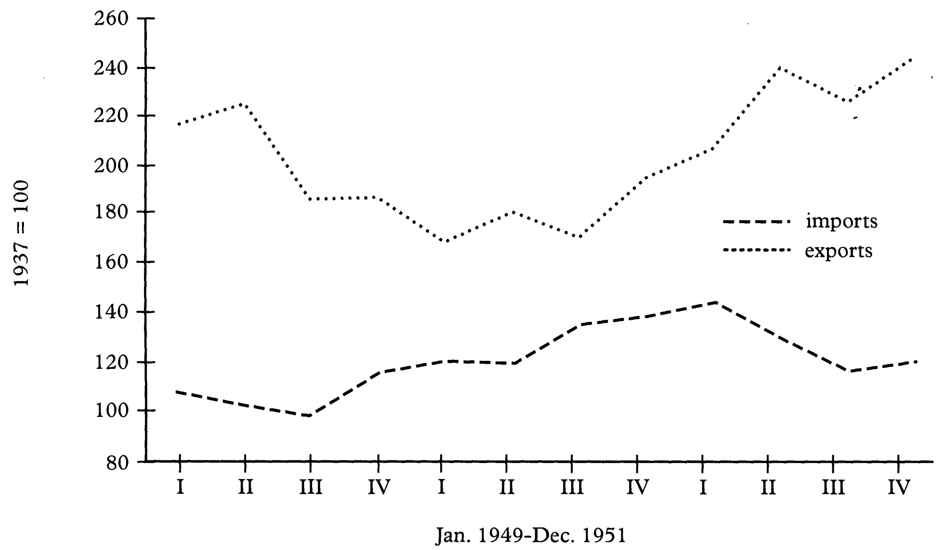

Figure 3. *United States: import and export quantities, 1949-1951*
Source: tab. A2

Neither is it the case that the United States stopped exporting as it turned its economy inwards to deal with the Korean conflict. Exports, which had been declining slowly during 1949, picked up in late 1950 and continued to rise into 1951. Even though US exports on an annual basis were lower in 1950 than in the adjacent years, the quarterly data reveal that the decline occurred in 1949, well before the Korean War, and that exports began to recover as the war started.

It is possible that the composition of exports varied in a way beneficial to West Germany, but there is no reason to expect it. To the extent that American car manufacturers turned from civilian cars for export to military lorries for Korea, this would have reduced, not redirected, exports. American lorries sent to Korea do not appear as exports. They were used to transport American soldiers and were not classed as an international transaction. The rise in exports late in 1950 therefore creates a presumption that the US presence in civilian international trade was unaffected by the war.

The aggregate trade data of West Germany and the United States appear to present a simple and straightforward refutation of the 'Koreaboom' story. The indirect channel noted above, however, would not show up in these data. Bilateral trade data for other countries are needed. As noted above, the indirect link could not have worked within 1950. For this reason—and because bilateral trade data are only available annually—table 3 reports results from regressions on annual data.

In addition to low frequency, there is a limited run of data because the world war preceded, and the German expansion of the 1950s, followed. The results in table 3 therefore are only suggestive. The figure for German exports to each of the listed countries was regressed on a time trend and a Korean War dummy that took the value one for 1951-3. Regressions were done both for a long sample of 1948-60 and a short sample of 1949-55. The long sample has the advantage of more data points; it has 10 degrees of freedom instead of four. But it also has the disadvantage of corrupting the evidence from the postwar expansion by confusing it with the European expansion of the later 1950s. One of the problems with historical econometrics is that events follow too rapidly on one another. Whichever period is used, the bilateral data confirm the view from the monthly aggregate data. The Korean War dummies are seldom significant and occasionally negative. West Germany was not moving into export markets abandoned by the United States.

Table 3. *Coefficients of a Korean War dummy in regressions of bilateral West German trade* (annual data)

Country	*Long trend (1948-1960)*		*Short trend (1949-1955)*	
	dummy	t-*statistic*	*dummy*	t-*statistic*
Argentina	37.493	9.29	37.635	6.816
Austria	−42.694	−2.369	−34.031	−1.91
Belgium-Luxembourg	2.906	0.186	12.724	1.437
Brazil	67.282	3.52	60.819	2.188
Denmark	25.583	1.678	20.207	1.348
Finland	21.333	1.251	30.816	1.592
France	19.786	0.301	24.473	1.165
India	−27.008	−0.962	−7.672	−0.667
Italy	16.594	0.688	15.8	1.202
Netherlands	−9.21	−0.252	−6.716	−0.164
Norway	5.541	0.555	10.989	0.869
South Africa	5.137	0.583	11.273	2.109
Sweden	32.557	1.593	27.32	1.223
Switzerland	18.68	0.752	33.731	2.052
Turkey	61.798	3.621	46.633	2.704
USSR	−21.459	−1.047	−9.203	−2.719
UK	32.141	1.207	48.967	2.016
US	12.985	0.249	54.858	3.258

Source: United Nations, *Yearbook of international trade statistics*, 1954, 1957

The US dummy is significantly positive for the shorter sample, although not for the longer one. Even if we accept this result as evidence of a demand shock to West Germany from the United States, the magnitude is small. The dummy coefficient is less than 3 per cent of West Germany's 1951 exports. Exports in turn were slightly less than 12 per cent of West German national income, making any demand stimulus from the rise in exports to the United States about one-third of 1 per cent of national income.[23]

The longer-run effect of the Korean War on German trade is hard to see. German trade was expanding rapidly, and the annual data and crude econometrics of table 3 fail to show a consistent effect. Even under the

[23] The extra exports may also have been offset by declines in exports elsewhere. The regression of total exports (for the shorter sample) yields a coefficient on the Korean War dummy that is positive but not significantly different from zero. The *t*-statistic was 1.77, well short of the 95% *t* with four degrees of freedom. Extending the Korean War dummy to 1950 to include the impact of the war analysed in the quarterly data increased the standard error on the US dummy, rendering the coefficient not significantly different from zero.

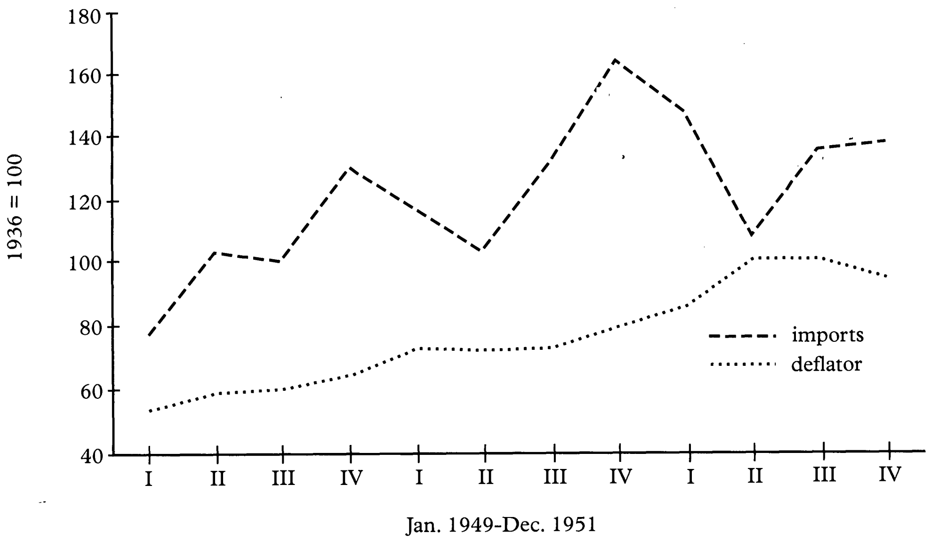

Figure 4. *West Germany: import quantities and deflator, 1949-1951*
Source: tab. A1

most favourable interpretation—looking at exports to the US rather than the total, and the smaller sample rather than the larger—the Korean War stimulus to West Germany was minuscule. The effect of the American Korean expansion on West Germany was confined to prices. The price rise in America affected international markets, and European prices must have shown similar movements.

IV

The question then is, what did happen to Germany in 1950? Figure 1, in addition to revealing what was not happening in West Germany, also shows what was happening. Even though exports did not experience any unusual movements in late 1950, imports did.[24] They rose quite dramatically in the final quarter of that year. As the graph shows, this rise was above the trend of imports, and it was not sustained. Imports had returned to what appears to be their long-term trend by the second quarter of 1951. There was a temporary spike in imports to West Germany.

Since prices rose at the start of the Korean War—at least in the United States—we need to ask if the rise shown in figure 1 was simply the result of inflation. Figure 4 shows real imports to West Germany together with a deflator calculated by dividing nominal by real imports. Two conclusions emerge. First, the quantity of imports peaked in the last quarter of 1950. The peak appears to be the culmination of a trend that started contemporaneously with the outbreak of the Korean War. If there was a causal relation, it operated without any perceptible lag. Secondly, import

[24] According to the OECC data cited above, this was atypical of Europe as a whole in late 1950.

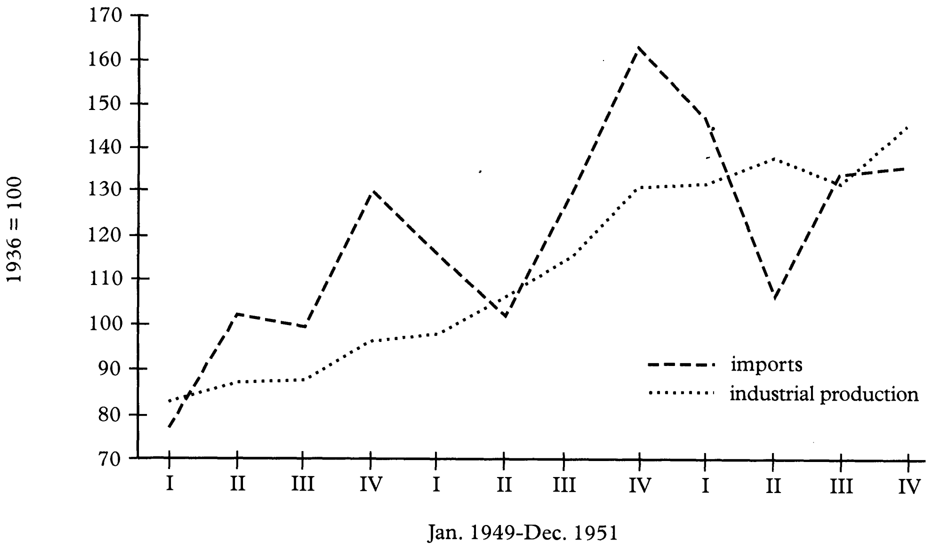

Figure 5. *West Germany: import quantities and industrial production, 1949-1951*
Source: tab. A1

prices rose, starting also at the outbreak of the war. The import price deflator is not a true price index, and it therefore does not give an accurate picture of the magnitudes involved. Nonetheless, a rise in the deflator of over 40 per cent for the year from the summer of 1950 is a significant increase.[25] Figure 4 also shows that there was another temporary rise in real imports in the fourth quarter of 1949. It did not have the cumulative impact of the 1950 rise both because it was shorter and because prices were lower. (Compare figure 1).

Why did imports rise? The imports were not simply intermediate goods for a production boom. West German production did not rise in step with the imports. Industrial production is shown in figure 5 together with the real import series from figure 4.[26] There is a modest expansion of industrial production in the last quarter of 1950, but it is dwarfed by the increase in the quantity of imports. It was not the case that a production boom simply increased the demand for intermediate products. A regression similar to those underlying table 3 on West German industrial production reveals an unusual increase in production in late 1950 of about 10 per cent.[27] Imports,

[25] Germany's terms of trade (calculated in the same way as the 'price' of imports in figure 4) moved with the import price in 1950, but did not deteriorate as fast as the price of imports rose in 1950 because export prices also rose in 1951. The price of imports rose by one quarter in both years, but the terms of trade moved only 10% in 1951: United Nations, *Monthly bulletin of statistics*, 1951-2.

[26] The industrial production data shown here, from the United Nations, differ slightly from those reported by Abelshauser, taken from West Germany, *Statistisches Jahrbuch*, 1952, p. 209. The only difference other than apparent rounding errors is that 2% of production reported to the United Nations in 1951.I was reported by the *Statistisches Jahrbuch* in 1950.IV. See Abelshauser, *Wirtschaftsgeschichte der Bundesrepublik Deutschland*, Table 11, p. 64.

[27] Data from the sources underlying table A1. Dummy variables starting in July 1950 and ending at various plausible dates all gave roughly the same result, both for monthly and quarterly data.

by contrast, rose about 30 per cent in each of the third and fourth quarters of 1950. Disaggregated import data reveal that the expansion of trade was very general; the composition of trade did not vary as imports increased. All major categories of imports—foodstuffs, industrial raw materials, manufactured goods—participated in the rise.[28]

West German consumption rose sharply in late 1950. The Bank Deutscher Länder, in its annual report for 1950, reported that, 'there began a wave of covering purchases on all sides, especially since the effect of the first fears that the Korean war might be extended to Europe was soon increased by the rise of prices on the international markets for raw materials, as well as by the fear of lasting scarcities.'[29]

The increase in German demand was helped by easier credit conditions and tax reductions.[30] It leaked out of West Germany in part because the West German economics minister, Ludwig Erhard, liberalized West German trade as part of his programme of introducing free markets. He celebrated the beginning of the EPU in mid-1950 by widening or removing quotas on the imports of manufactures and raw materials. In addition, speculative activity increased West German imports. A rumoured imminent revaluation of the British currency led to faster payments and slower billing to sterling areas. One account attributes almost half of the West German deficit to this cause.[31] The Germans rushed to anticipate price rises while the British held back to maintain unselfishly the new international order.

The best way to see the immediate impact of the Korean War on Germany, therefore, is not as a stimulus to domestic activity. To the extent that the war led to speculative imports, it was instead a loss of foreign exchange. This loss was coupled with an increase in the price of imports that raised the prospect of inflation, not only in Germany, but throughout the industrialized world.

In the conventional division of macroeconomics, the rise in speculative purchases in West Germany was a positive demand shock. But it did not benefit the West German economy. It leaked out to other countries, increasing West German imports rather than West German production. The rise in import prices was a negative supply shock. The combination had little effect on production; it only raised prices. And as these were small shocks, the inflation was small as well.

This is consistent with the view articulated by Milward in his study of the postwar reconstruction. In his words: 'The outbreak of war in Korea produced a world-wide run on raw materials which shifted the terms of trade against the Federal Republic at the very moment when it was the most vulnerable to such a movement, because it was in no position economically or politically to reduce its imports'.[32] In fact, West Germany

[28] West Germany, *Statistisches Jahrbuch für die Bundesrepublik Deutschland*, p. 237.

[29] Bank Deutscher Länder, *Report for the year 1950*, p. 6. The bank added that production, particularly of consumption goods, rose rapidly, and that imports increased. As shown in figure 5, however, imports rose far more than production.

[30] Bank Deutscher Länder, *Report for the year 1950*, p. 7.

[31] This account is taken from Kaplan and Schleiminger, *The European Payments Union*, ch. 6.

[32] Milward, *The reconstruction of Western Europe*, p. 429.

increased its imports at exactly this unfavourable time. The balance of payments crisis was due more to the movements of quantities than the change of prices. The rise in imports and prices must be seen as adverse shocks to the West German economy. Since that country had almost no foreign reserves, the combination of an increase in imports and higher import prices precipitated a balance of payments crisis for West Germany that posed a thorny problem for the nascent EPU.

The EPU had set quotas for the member countries based on their 1949 intra-European trade. West Germany's trade had not revived as quickly as that of other countries, and it received a low EPU quota. As a result, West Germany would have to pay an increasing share of its deficit in gold, reaching 100 per cent before the end of 1950. The country did not have the foreign exchange reserves needed to effect this transaction. The resulting problem emerged at the EPU managing board's first meeting in October 1950.

The EPU was faced with a problem similar to that encountered by the United States and France in July 1931. The German economy had run out of reserves at that time too, and it appealed to other countries for help.[33] Loans were forthcoming in 1931 only under unacceptable political conditions, and the great depression intensified. Suspicion of Germany was also high in October 1950. The Americans, in particular, were not charitable. As in 1931, the Germans were suspected of using the international monetary system for their own nationalistic aims.[34] Happily, these negative views did not prevail. The EPU called in the expert team of Cairncross and Jacobsson who argued that the West German trade imbalance was only temporary. The EPU extended a $120 million credit to West Germany with macroeconomic conditions.[35] As requested, the West Germans tightened credit in late 1950 and early 1951. Erhard also suspended some of his trade liberalization, formalizing the change in February. A trade balance surplus appeared in March 1951.

This small crisis tested the postwar relations between the victors and the vanquished. By extending a hand to the nascent West German economy, the EPU welcomed it into the community of cooperative nations. This helped to stabilize the leadership of West Germany and its outward-looking policies. It redounded also to the credit of the fledgling EPU.

The EPU's intervention was timely and effective. A small balance of payments problem was contained. It did not escalate to the point where international financial arrangements were strained beyond endurance and broke down. The EPU loan therefore is seen as a minor event in the postwar recovery.

But what is the counterfactual? What would have happened in the absence of EPU support for West Germany? The example of 1931 is too extreme. The world economy was not collapsing, and the Nazis were not ascending in 1950. But the earlier episode does remind us that there are discontinuities

33 Temin, *Lessons from the great depression.*

34 Milward, *The reconstruction of Western Europe*, p. 425.

35 The credit was 60% of the $200m deficit West Germany was expected to run from November 1950 to March 1951: Kaplan and Schleiminger, *European Payments Union*, p. 108.

both in national policies and in international financial arrangements. The EPU policy was important because it kept West Germany and the EPU away from these discontinuities and irreversible changes. It made a positive contribution to the postwar recovery. This is not to say that if all other policies had been as they were and only the EPU aid to West Germany were changed, then the postwar recovery would have been aborted. That aid was part of the postwar policy of cooperation between western European countries and the United States. These policies were effective in promoting economic recovery and growth. The balance of payments loan was just one part of a complex, interrelated programme—but a part whose effect can be seen and whose impact was clearly beneficial.

V

This has been a simple exercise. It needed only a clear look at the figures to show that the 'Koreaboom' in West Germany never took place, that the Korean War generated problems, not solutions, for the West German economy and Ludwig Erhard's free-market policies. In addition, this was the dominant contemporary view. The United Nations' *Economic survey of Europe*, for example, stated that 'International trade and payments [was] violently disrupted away from the more orderly progress under way before Korea.' Neither the United Nations nor the OEEC regarded the Korean War as anything other than a disruptive force.[36]

Yet the idea of a war-induced boom has taken hold and even increased in popularity over time—and for several reasons. As noted above, the trend of recent scholarship has moved to denigrate the role of international cooperation and international organizations in the postwar recovery. The true story of the Korean War shows that the EPU responded well to a test of the international system and prevented a minor problem from escalating into a major one. But it is more consistent with the tone of current discussion to have the EPU inert and the Korean War beneficial. This reason may explain Abelshauser's view.

In addition, the Korean War was a major political event in Europe. Even though the fighting itself was far away, American attitudes towards a possible war in Europe changed dramatically. Instead of thinking about reducing military expenditures after the last European war, the Americans urged everyone to consider increasing them in anticipation of the next war. The Americans put their money where their mouth was and supplied scarce dollars to promote an expansion of military spending. Giersch *et al.* discuss the politics of the Korean War at length; they may have assumed that the economic importance equalled the political.[37]

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[36] United Nations, Department of Economic Affairs, *Economic survey of Europe in 1951*, p. 3; Organization for European Economic Co-operation, *Economic progress and problems of Western Europe*, pp. 99-103. See also Milward, *Reconstruction of Western Europe*, p. 489.

[37] Giersch, Paqué, and Schmieding, *The fading miracle*, pp. 101-5. I cannot resist noting that Giersch and his co-authors begin their preface by declaring, 'This book is an essay in applied economics, not in economic history' (p. xi). On this issue, the book reads like the *old* economic history.

APPENDIX: West German and US data, 1949-1951

Table A1. West German data (million DM, 1936 = 100)

Quarter	*Import values*	*Export values*	*Import quantities*	*Import deflator*	*Industrial production*
1949 I	412	277	77	53	83
1949 II	605	305	102	59	87
1949 III	595	316	100	59	88
1949 IV	831	370	130	64	97
1950 I	832	502	116	72	98
1950 II	739	596	103	72	106
1950 III	940	725	131	72	116
1950 IV	1,281	964	163	78	131
1951 I	1,240	995	147	84	132
1951 II	1,066	1,181	107	100	138
1951 III	1,326	1,347	134	99	132
1951 IV	1,276	1,336	137	93	146

Source: United Nations, *Monthly bulletin of statistics*, 1951-2

Table A2. US data (million $, 1937 = 100)

Quarter	*Import values*	*Export values*	*Import quantities*	*Export quantities*
1949 I	597	1,108	107	216
1949 II	534	1,121	101	225
1949 III	492	898	98	185
1949 IV	585	880	115	186
1950 I	629	788	120	167
1950 II	644	837	119	179
1950 III	797	817	135	170
1950 IV	881	983	138	193
1951 I	1,011	1,111	143	206
1951 II	994	1,340	129	239
1951 III	832	1,229	115	225
1951 IV	818	1,326	120	243

Source: United Nations, *Monthly bulletin of statistics*, 1951-2

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