



The Commanding Heights

The Battle between Government and the Marketplace
That is Remaking the Modern World
by Daniel Yergin and Joseph Stanislaw
Copyright © 1998 by Daniel Yergin and Joseph Stanislaw
Published by Touchstone/Simon & Schuster, Inc. N.Y.
Used by permission.
464 pages

Focus

Leadership
Strategy
Sales & Marketing
Corporate Finance
Human Resources
Technology
Production & Logistics
Small Business
▶ **Economics & Politics**
Industries & Regions
Career Development
Personal Finance
Self Improvement
Ideas & Trends

Take-Aways

- In the wake of World War II, capitalism was widely discredited by the ravages of war and the economic depression of the 1930s.
- Soaring productivity levels during World War II proved that governments could efficiently manage economies.
- Throughout Europe, governments began to seize the commanding heights of their economies by nationalizing crucial industries.
- The British Labor Party believed that it could eliminate unemployment and other market failings by controlling the economy's commanding heights.
- The apparent weakness of the market system spurred consensus on the need to expand government in France.
- Europe needed a strong Germany to recover from World War II.
- Konrad Adenauer implemented a German social market economy that was committed to free markets and a social safety net.
- Abolishing the Nazis' system of allocations and price controls began the *Wirtschaftswunder* — the German economic miracle.
- The fall of communism demonstrated the failure of planned economies.
- As governments retreated in the 1990s, the marketplace began to regain control of the commanding heights.

Rating (10 is best)

Overall	Applicability	Innovation	Style
8	5	10	8

Review

The Commanding Heights

The second half of the 20th century was marked by the ebb and flow of government influence over national and international economies. Daniel Yergin and Joseph Stanislaw characterize the balance between government and private marketplace clout as a battle for the commanding heights of the economy. They trace this fight back to the years after World War II, where they discover that capitalism had been widely discredited and governments were basking in the glow of wartime victory. With descriptions of the catalytic people and events that moved markets and policy, Yergin and Stanislaw have turned an essentially academic topic into a readable book, which is as much about economics as it is about history. As engaging as the stories are, don't assume you're in for a light read. Many business books today have plenty of sizzle, but not much steak. *getAbstract* recommends that you sink your teeth into this big, juicy T-bone of a book, a rare treat for intellectual readers searching for economic adventure and substantive history.

Abstract

"Government knowledge — the collective intelligence of decision makers at the center — was regarded as superior to market knowledge — the dispersed intelligence of private decision makers and consumers in the marketplace."

"War itself had vastly enlarged the economic realm of government."

"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."

World War II Fallout

In July 1945, Harry Truman, Joseph Stalin and Winston Churchill met in Potsdam to plan the final act and the aftermath of World War II. After nine days, Churchill interrupted the meeting to return home for the British general election. He assumed he would be able to return quickly to the negotiating table. Instead, capitalizing on fears of a return to the unemployment and deprivation of the 1930s, the Labor Party won in a landslide. Clement Attlee replaced Churchill as prime minister. When Attlee took Churchill's place in Potsdam, Stalin was confused, as though the switch was some type of trick. (Stalin's foreign minister even asked Attlee why Churchill wouldn't have "fixed" the election results.)

Attlee and the Labor Party launched programs that began a new era in which governments attempted to gain control of the commanding heights of their national economies. While they permitted some privatization, a state-owned sector controlled key industries such as railroads, utilities and telecommunications. Labor established and legitimized this "mixed economy" model. Strong, direct government involvement arrived in the form of fiscal management policies, an expansive welfare state and the creation of a state-owned sector to coexist with the private sector. Labor's efforts marked the beginning of a political and economic wave that flowed around the world until it peaked in the 1970s.

Britain: Controlling the Commanding Heights

Labor was determined to fight unemployment. The party viewed the hardship of the 1920s and 1930s as a failure of capitalism and saw capitalists as mean-spirited business people who hoarded profits, deprived their workers and ignored new technologies.

British socialists looked abroad to see how other governments were dealing with these problems. Some countries followed a model of optimistic activism and interventionist reforms, such as Franklin Roosevelt's New Deal. Others admired the "heroic" accomplishments of communism, socialism and central planning in the Soviet Union.

“The appalling conditions of post-war life seemed to provide the circumstances for implementing a socialist vision.”

“The limitations and rigidity of central planning — and ultimately, its fatal flaw, its inability to innovate — were still decades away from being evident.”

“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.”

“Members of the Labor Party called themselves socialists. But it was a British brand of socialism that owed much more to 19th century utopian Robert Owen than to Karl Marx.”

World War II proved that the British government could effectively manage the British economy. Government control of the industrial machine resulted in more production than capitalist owners could achieve before the war. The war turned the national economy into a common cause, and the British population rallied behind it.

This success led to the rejection of traditional, 19th-century liberalism. After the war, people no longer believed that the individual’s pursuit of “self-interest” would lead to the benefit of all. Clement Attlee even declared that a belief in private profit as a motive for economic progress was “a pathetic faith resting on no foundation or experience.”

Once in power, Labor wanted to build what it called “the New Jerusalem,” by using the lessons of history to transform the role of government. Labor wanted government to be the people’s protector and partner, to be responsible for its citizens’ well being. The Beveridge Report was the blueprint for these goals.

The Beveridge Report identified social programs that would destroy the “five giants” of want, disease, ignorance, squalor and idleness. This report changed the way Britain and the rest of the industrialized world saw the obligations of the state. Implementing the report’s recommendations, Labor created the National Health Service, new pension systems and better education and housing. The government made a commitment to deliver “full employment” through the welfare state.

To gain control of the economy’s commanding heights, Labor nationalized major industries — coal, rail, utilities, international telecommunications, iron and steel. Run privately, these industries were inefficient, under-invested and small. Nationalization would help them mobilize resources, adapt new technologies, grow in scale and become more efficient to achieve the national goals of economic growth, full employment, justice and equality.

Nationalization used a model known as the state-owned corporation, making a government-appointed board responsible for running the corporation. How could the activities of these public corporations fulfill the Labor Party’s promises? Planning would be the key to nationalization.

These newly nationalized industries eventually employed about 20% of Britain’s workforce. But, postwar, the country essentially was bankrupt. Britain had spent an enormous amount of its national wealth to defeat the Axis. A general economic crisis began in 1946, ending any further attempts to take control of additional “commanding heights.” Labor never implemented much of its rhetoric, and it abandoned the idea of central planning. While food rationing continued until 1954, the Attlee government remained able to provide a welfare state, including access to health care and better education. Unemployment, as high as 12% in the 1930s, dropped to 1.3% in the 1940s.

France: The Monnet Plan

Postwar France also viewed capitalism as “rotten.” The French saw capitalism as a backward, narrow-minded system, retarded by insufficient investment. The capitalist system had been discredited before World War II. In 1939, industrial machinery in France was on average four times older than American machinery, and three times older than British equipment. Production per hour in France was one third of American output and one half of Britain’s. France’s per capita income was the same in 1939 as it had been in 1913.

“This ‘mixed economy,’ with its welfare state, became the basis of what has variously been called the postwar settlement and the Attlee Consensus. Whatever the name, it would have a profound impact around the world over the next four decades.”

“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.”

“‘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.”

World War II had accelerated the criticism of capitalism. France’s military and political weakness was a failing of its backward economic organization. The old economic system could not provide for the needs of reconstruction. Meanwhile, wartime collaboration under the puppet Vichy regime had tainted much of French business.

The apparent weakness of the market system helped create a consensus about the need to expand government. The new head of the government, Charles de Gaulle, declared, “The state must hold the levers of command.” Government would build a new, vigorous France based on a three-sector economy — private, controlled and nationalized.

Nationalization would provide investment, modernization and technological progress. It would prevent monopolies and consolidate fragmented industries. Thus motivated, the French government took control of banking, electricity, gas, coal and other industries.

By 1947, the French realized that the government had given too much power to board members from Communist-controlled unions. This gave the communists excessive authority, which they quickly abused. The episode soured the taste for further nationalization. France, too, evolved into a mixed economy.

Jean Monnet most clearly understood the war’s devastation and the requirements of reconstruction. He created the Monnet Plan to deal with two critical issues on France’s postwar economic agenda: the balance-of-payments crisis and the need to modernize.

The Monnet Plan prioritized, set investment targets and allocated investment funds with a focus on reconstruction of basic industries: electricity, coal, rail, steel, cement and agricultural machinery. Monnet believed that setting targets would keep France from falling back into its prewar, risk-averse ways.

While the plan did not meet all of its targets, it did provide discipline, direction, vision, and confidence to a nation that easily could have remained in deep distress.

Germany: The Wirtschaftswunder

Capitalism faced its harshest criticism in the four occupied zones of postwar Germany, due to big business’ complicity with Hitler. The Social Democrats (SPD), the only party to fight the Nazis, were intent on creating a noncapitalist future. Led by Kurt Schumacher, it committed itself to nationalization and strong central planning. But within a year, Germany would take a different economic path because of Soviet expansionism, which divided Germany. The other impetus was the integrated European economy that emerged under the Marshall Plan. The Western allies realized Europe’s recovery required a strong Germany at its heart.

Ludwig Erhard, economics director for Bizonia (the American and British occupation zones), was instrumental in Germany’s recovery. An Ordoliberal, Erhard believed that competition best prevented the private and public concentrations of power seen under Nazism. He held the government responsible for promoting competition while preventing cartels. The Ordoliberals believed in a “social market economy.” They supported a social safety net. One of Erhard’s most dramatic moves was the complete abolition of the Nazis’ system of allocations and price controls. This eliminated the gray and black markets overnight and began the economic miracle in postwar Germany.

In September of 1949, Schumacher’s Social Democrats and its “planned economy” platform lost narrowly to Konrad Adenauer’s Christian Democratic/Christian Socialist party

“Conditions were so deplorable [in Germany] that the Catholic archbishop of Cologne told his faithful it was all right to steal food to survive.”

“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.”

and its platform of a social market economy. Ludwig Erhard served as economic minister for the next 14 years. The result was the *Wirtschaftswunder*, the German economic miracle.

While the social market economy looked very similar to the mixed economies of Britain and France, crucial differences existed. Instead of taking the commanding heights as the English and French had, Germany created a network of organizations to help the market work more effectively. Government, business and labor shared economic control through supervisory boards called *Betriebsräte*. In less than a decade, this unique model transformed Germany from an economic wasteland to the center of the European economic order.

Postwar Postscript

Western European countries enjoyed an extraordinary economic record in the postwar years. Their mixed economies delivered a standard of living that no one could have imagined in 1945. Production exceeded prewar levels by 1955, and unemployment disappeared. This success solidified the idea that government must control the economy — and, often, own part of it — to provide prosperity for all. Government took responsibility for correcting the “failures” of the market.

For the next 30 years, other countries adopted the mixed economy model. But by the 1990s, government would begin its retreat. Communism had failed as an economic system. Governmental failure had replaced market failure. Disillusioned with the high costs of control, Western governments turned to privatization, opening the doors of formerly closed countries to trade and investment. Capital and technology became able to move more easily in search of new opportunities. Now, the marketplace appears ready to regain control of the commanding heights. Maintaining that control will require a shift in beliefs and ideas away from the traditional faith in governments and toward greater market credibility.

About The Authors

Daniel Yergin is the Pulitzer-winning author of *The Prize: The Epic Quest for Oil, Money, and Power*. He also wrote *Shattered Peace*, and co-authored *Energy Future* and *Russia 2010 and What it Means for the World*. Joseph Stanislaw, president of Cambridge Energy Research Associates, is a leading adviser on international markets and politics.

Buzz-Words

Beveridge Report / Central planning / Commanding heights / Levers of command / Mixed economy / Monnet Plan / Ordoliberals / Privatization / Social market economy / *Wirtschaftswunder*