L.5.2
CONFIDENTIAL

Board of Governors of the Federal Reserve System
Division of Research and Statistics
International Section

REVIEW OF FOREIGN DEVELOPMENTS

October 22, 1945

....

Tied Loans and United States Commercial Policy

Howard S. Ellis

In its General Policy Statement issued in September 1945, the Export-Import Bank of Washington sets forth the policies which have guided its lending operations since its organization in 1934. Amongst these, the fourth "basic principle" is as follows:

> "As a general rule, the Bank extends credit only to finance purchases of materials and equipment produced or manufactured in the United States and the technical services of American firms and individuals as distinguished from outlays for materials and labor in the borrowing country or purchases in third countries. The reasons for doing so are principally two: (1) The limited resources of the Bank should be used with rare exceptions solely for the purpose of directly financing and facilitating United States foreign trade; (2) foreign countries should not ordinarily assume external indebtedness to finance expenditures in local currency."

This re-affirmation of the Bank's policy of issuing only tied loans raises a serious issue in view of the magnitude of actual impending operations by the institution. As reported in this Review on October 8 (p. 3), the present authorization of $3.5 billion lending capacity may be exhausted in the present fiscal year, and a doubling of this capacity may be proposed shortly. Tied loans upon this scale could easily account for the greater part of our net foreign lending during the next few years. In comparison, the tying of loans under the International Bank for Reconstruction and Development applies only to the Bank's own loan fund ($1.82 billion) and even within this limit only to cases where the lending country refuses permission to the Bank to convert its own currency into another currency.

In justification of a policy which would cause the larger part of the foreign lending program of the United States in the near and crucial future to be strictly bilateral, the General Policy Statement of the Export-Import Bank refers in the first place to the "limited resources of the Bank." This implies that unless lending agreements required the expenditure of the funds upon our produce and manufactures, foreign countries would not do so. The limited productive capacities of other industrial countries as a consequence of war damage affords practical insurance, however, that most of the dollars supplied by the United States through foreign loans will be applied directly to purchases from us.

Over the longer period when foreign industrial economies may have recovered from the war, they will indeed compete more effectively on world markets with U.S. exports. But it is precisely with regard to this somewhat longer future that the United States--for the sake of fair competition, full employment, high standards of living, and political security in the international scene--is now bending its efforts toward securing general acceptance of its traditional position for free multilateral trade. The persistence of a policy of issuing large volumes of tied loans cannot be made consistent with this declared position. From the viewpoint of free and flourishing multilateral trade, the fact that the resources of the Export-Import Bank are limited is, indeed, a very good reason for refraining from tying provisions. Only if its resources were many multiples of its present position could the restriction and discrimination of tying $3.5 billion be regarded as relatively minor.

The second reason adduced in the General Policy Statement for extending credit only for goods produced in the United States, that foreign countries should not contract foreign indebtedness "to finance expenditures in local currency," does indeed give a valid rule as to the aggregate extent of their borrowing. It supplies no reason at all, however, as to why this borrowing should involve necessarily expenditures upon the goods of the creditor country, rather than upon the goods of another and competitive foreign supplier. There would indeed be every reason to observe the ordinary rule of purchasing in the cheapest and best market. If the United States desires to benefit from this principle in its own imports, it can scarcely deny other countries the same privilege.

The U.S.S.R. and Bilateralism in Eastern Europe A. Gerschenkron

The economic relations between Russia and countries located in Russia's zone of influence in Eastern Europe are in the main regulated by (1) agreement on economic collaboration, (2) bilateral trade agreements, and (3) in the case of Finland, Hungary, and Rumania, the reparation provisions of the armistice agreements.

One of the principal questions raised by Russia's policies in Eastern Europe is to what extent Russia will endeavor to establish preferential positions in the economies of the countries concerned and thus discriminate against trade and investment of third countries. There is little doubt that the institutional pattern that has been so far created may be used as a powerful vehicle of discrimination in international trade. Although information remains fragmentary, there have been a number of indications that the Russians are trying to establish preferential, if not exclusive, positions in the economies of the countries concerned. It is therefore very important to watch these developments closely and also to consider seriously ways and means of preventing, or at least of minimizing, discrimination in the area in question. At the same time, however, it is advisable to remember that no useful purpose can be served by premature conclusions based on one-sided interpretations of the developments. In particular, confusion of potential with actual discrimination should be avoided. This need for a judicious approach may be illustrated in connection with the trade agreements which have been concluded in recent months between Russia and the countries of the zone.

According to the information so far received, the following trade agreements are in existence:

Russian Trade Agreements with
Eastern European Countries

Country	Period of Validity	
Rumania	May '45	May '46
Hungary	Sept.'45	Dec.'46
Poland	July '45	Dec.'45
Finland	May '45	Dec.'45
Czechoslovakia	?	Dec.'45
Bulgaria	March '45 -	Dec.'45
Yugoslavia	Not known -	Not known

The list shows that trade agreements have been concluded with all countries located in the Russian sphere of influence, with the exception of Austria, the position of which with regard to Russia is more complicated because the country is not under exclusive Russian control.

The outstanding characteristic of all these agreements is that they are based on the principle of equality of exports and imports; in other words, they are strictly bilateral payment arrangements. This fact has been considered by some as clear evidence of

Russia's intentions to pursue discriminating trade policies in Eastern Europe. However, the mere fact of the existence of these bilateral trade practices cannot as yet be taken as a piece of conclusive evidence of Russia's ultimate intentions. For it is extremely questionable whether any other type of trading arrangement could be considered feasible in the period immediately preceding and following the end of hostilities in Europe. Under the conditions of general reduction of productive capacity and of disastrous disruption of the means of communication now ruling in Europe, bilateral arrangements provide a natural solution for the problem of meeting the urgent demand for imports to feed the populations and to begin reconstruction. If payment for exports by concomitant imports is not provided, credits or payments in gold or foreign exchange would be necessary. It is clear that the East-European countries, with the possible exception of Rumania, would not be able to finance an export surplus to Russia, or to provide gold or foreign exchange to pay for an import surplus from Russia. On the other hand, Russia certainly could pay in gold for her import surplus from any of the countries concerned. Yet, in the period under consideration, gold is undoubtedly the commodity least needed in Eastern Europe. Thus, under prevailing conditions, the choice is largely between bilateral trade or no trade at all. There is little point, therefore, in raising the charge of discrimination with respect to the trade agreements in question.

The future of these arrangements, however, is an entirely different matter. To the extent that productive facilities are being put back to use, that port installations are being restored and railroad bridges rebuilt; to the extent that credits are made available and, most notably, that the International Fund will begin its operations, the bilateral trade agreements between Russia and East-European countries will become an impediment to the reconstruction of European trade on a multilateral and non-discriminatory basis. As shown above, only two of the present agreements do not expire with the end of the current year. This in itself might justify the hope that the arrangements have been conceived by Russia as short-lived emergency measures. It should be noted, however, that discontinuation of these measures would not necessarily mean transition to multilateral trade. Russia's influence in Eastern Europe is presumably so strong that she will not feel compelled to apply the principle of "divide and rule" to her economic relations with this area. On the contrary, the temptation for Russia may lie in the direction of a clearing bloc comprising all Eastern Europe with Moscow as the center. This would be a very undesirable development indeed as it would seriously interfere with the foreign economic policies of this country and with the principles and activities of the prospective international trade organization.

It would, therefore, be very desirable if, among other issues, the question of future trade relations between Russia and Eastern Europe were raised in the course of negotiations concerning American loans to Russia. Assurances should be sought that, after a reasonable period of transition, bilateral arrangements will be discontinued and the countries in question integrated directly into a system of multilateral world trade.

Program for Disposal of British Empire Surplus Wool — Toni Giese

As a result of the bulk-purchasing programs by which the United Kingdom sought to insure an adequate war-time supply of apparel wool for itself and its allies, the British Government, as of the end of June, possessed surplus stocks of Dominion wool estimated at 3,315 million pounds. This tremendous accumulation is somewhat greater than the world's annual production of apparel wools, or more than twice as large as the average annual exports of Australia, New Zealand, and South Africa which together furnished approximately two-thirds of the apparel wool entering into international trade in pre-war years. In recognition of the fact that any attempt to dispose of these stocks rapidly would seriously injure the domestic economies of the wool producing Dominions, and at the same time create a weak market for the British-owned stocks, the governments concerned have agreed to the establishment of a Joint Organization through which the surplus stocks will be marketed concurrently with new clip wools from the three Dominions. British experts have estimated that under favorable conditions of high world purchasing power some 13 years may be required for elimination of the current surplus. A marketing scheme of this magnitude and intended duration will affect producers and consumers of wool throughout the world. The background of the existing surplus, the probable demand and supply situation in the immediate future, and the form and proposed policies of the marketing organization deserve careful study.

In September 1939, the United Kingdom made arrangements to purchase all exportable surpluses of Australian and New Zealand wools for the war period plus one full year thereafter; in 1940 a similar agreement was reached with the Union of South Africa. Prices paid by the United Kingdom under these agreements were considerably higher than those prevailing in earlier years. The Economist discloses that the average price per bale of wool appraised or sold by Australia and New Zealand during 1943-44 was 44 per cent higher than the average price of the pre-war decade, and that average annual production in the three Dominions increased from 1,514 million pounds in 1934-38 to 1,668 million pounds in 1939-44. During the same period, effective world wool demand declined sharply. German dominance over most of Europe, and more specifically the complete collapse of French resistance in 1940, closed the important continental market for imported wools.

To the British surplus stocks of 3,315,000,000 pounds there may be added some 700 million pounds of South American and United States reserves. These stocks overhang a market characterized by increased productive capacity and by at least temporarily decreased absorptive capacity. Germany and Japan, formerly active markets for British wools, will be unable to purchase normal supplies of wool for several years. While the important French and Belgian textile mills remain virtually intact, shortages of fuel, dissipation of normal labor forces, and the disruption of transport facilities point to slow recovery of production. War-time priorities in the United Kingdom have restricted civilian consumption of wool to no more than 35 per cent of pre-war, while the industry's labor force has declined from 240,000 to approximately 130,000. More favorable aspects of the picture include the longer-run prospects of heavy consumer demand in many countries where wardrobes have been depleted during the war and the necessity for textile mills to replenish inventories. The British experts who have suggested that disposal of the surplus stocks may be accomplished in approximately 13 years based their estimates upon the optimistic assumption that a substantial increase in world purchasing power will result from successful prosecution of policies of full employment and expansion of world trade. If this increase eventuates, world wool consumption may reach a level 12 per cent above pre-war which would permit a 20 per cent increase in the consumption of British and South American wools. The group preparing this estimate recognizes, however, that even under favorable conditions of high world purchasing power, successful disposal of the surplus will demand that the price of wool and wool textiles be "a reasonable one which encourages consumption" and that prompt aid be given to needy countries both for rehabilitation of their textile industries and for expansion of their capacity to consume. In this connection, the Joint Organization intends to consult with specialized international wool organizations and with representatives of consuming countries on the possibilities of improving wool textile industries in consuming countries. Methods advocated include the replacement of antiquated and worn out machinery, adoption of improved methods of manufacture, processing and distribution, and increased emphasis on research and publicity.

Under these conditions, the four governments decided that in order to obtain fair and stable prices for both old and new wool and to provide a solution to a certain conflict of interests between Britain and her Dominions a cooperative system of controlled marketing would be required. The economies of the Dominions are dependent to a large extent on the export of wool and high prices are consequently desirable for them, while Britain as a net exporter of wool textiles is interested in cheap supplies of raw wool. This interest on the part of Britain, however, is limited by the fact that it is now in the position of a seller as well. Controlled marketing was deemed to be the only alternative to the disastrous effects of a free-market which might benefit the numerous wool consumers, but which would undoubtedly prejudice growers' interests everywhere and endanger the stability of the Dominion economies.

The new plan for controlled marketing was the outcome of the London Wool Conference (April 16 to May 28, 1945) which recommended formation of a Joint Organization, a partnership composed of the United Kingdom, Australia, New Zealand, and the Union of South Africa to share in the ownership of the stocks of wool, in responsibility for their disposal, and in the resulting profits or losses. Dominion wool held by the British Government as of July 31, 1945, will be transferred to the Joint Organization. The capital of the Organization, represented by the opening stock of wool, will amount to 160 million pounds sterling of which Australia will take up one-fourth and New Zealand and South Africa one-eighth each. The capital payments due from the Dominions may be met in four annual installments and each Dominion's share in the proceeds of sales from the Joint Organization's stocks may be applied against its original obligation. Operating expenses are to be shared equally by growers, whose liability will be paid by their respective governments from charges levied on sales of new clip wool, and by the Joint Organization itself, which will deduct its share from the proceeds of sales of its own wool. The net profits are to go toward the repayment of the original capital.

The functions of the Organization have been laid down as follows:

1. Determine amounts of wool (including all new clip and an appropriate proportion of the Organization's stocks) to be offered for sale from time to time concurrently in the Dominions and elsewhere.

2. Prepare schedules of reserve prices at which the Organization itself will be willing to purchase the wool.

3. Lift from the market quantities of new wool which cannot be sold to buyers at reserve prices.

4. Hold and dispose of stocks as agent of the Governments concerned, and acquire and own warehouses, plant and equipment for this purpose.

5. Facilitate sale of wool in every possible way to stimulate demand.

The United Kingdom wool stocks were transferred to the Joint Organization on July 31, 1945, but that body will not assume full authority until its organizational plans are completed. In the interim period, the United Kingdom will undertake to purchase the entire exportable surplus from the 1945-46 clip[1/] and the British Government Wool Control will continue to administer sales of wool at the established ceiling prices until the Joint Organization is fully established. It has been deemed wisest to continue the present system of appraisal and sale of wool at fixed prices until conditions of free demand shall have been restored in the principal consuming countries.

When the Joint Organization assumes control of marketing, the sale of wool will be effected at auctions. Old wool, in amounts to be determined by the Organization, will be offered concurrently with the entire new clips at minimum reserve prices, below which wool will not be sold. If the offerings of new wool are not disposed of at or above the minimum reserve prices, the Organization will be prepared to purchase them at the established minimum price. These minimum reserve prices are to be determined from time to time by representatives of the four governments on the basis of recommendations prepared by the Organization. Representatives of consumer countries will be invited to consult with the Organization on price and other problems. Certain price variations depending on customary differentials in the quality of wools will be established. If necessary, the Organization will decrease its offerings or adjust its prices to conform with the demand

1/ This arrangement differs from the war-time procedure in that the Dominions undertake to reimburse the United Kingdom for one-half of the cost of any portion of the clip remaining unsold at the end of the wool year.

situation. The Organization may decide to make standing offers for sales outside auctions at fixed prices somewhat above auction reserve prices; this would serve the double purpose of imposing a ceiling on prices obtainable at auction and of diminishing the surplus.

The Joint Organization is the present-day counterpart of the successful British-Australian Wool Realization Association (popularly known as Bawra) formed in 1920 for the similar purpose of disposing of surplus war-time stocks. At that time, however, stocks amounted to only 30 per cent of the present surplus and were sold in about four years, the last sale taking place on May 2, 1924. The task of the present organization, therefore, is far greater.

During the first World War, an Imperial Wool Council was organized to purchase clips from the Dominions and Colonies for the purpose of fulfilling war-time needs. The agreement with Australia provided for the purchase of all Australian wool for the duration plus one year at a fixed average price. Funds for these purchases were advanced by the British Treasury and all profits were divided between the United Kingdom and Australia. After the war, increased civilian demand raised wool prices so that the Wool Council was able to pay off all Treasury advances by the sale of only a part of its surplus; the residual stock of 2,700,000 bales of wool, together with other assets on hand, accordingly belonged in equal shares to the Imperial authorities and to the growers whose wools were acquired during the 1916-17 to 1919-20 period. The demand in 1920 was clearly not great enough for new clips and old wool to be sold simultaneously, and when the surpluses began to depress the market, Bawra was created to coordinate selling policies.

The Australian half of the assets of the Imperial Wool Council valued at £ 25,000,000 was transferred on January 1, 1921, to Bawra, which was organized as a purely Australian company. An agency contract was then arranged between the United Kingdom Government and the Association for the sale of British stocks on a commission basis. By the terms of the contract, the surpluses of both countries were lumped together and the proceeds of every sale were shared by the British Government and the Association. Surplus wools were removed from Australia so that normal market conditions might be restored there, and were sent to England for marketing in Great Britain and on the continent.

In order to assure the disposal of old wool concurrently with new clips, Bawra decided that a given proportion of old wool should be offered concurrently with new clips at fixed price limits. The proportion was originally set at two-thirds old wool to one-third new. Only 18 per cent of the offerings were sold under this arrangement and the proportion was changed to a 50-50 basis. This procedure worked satisfactorily for a short time. In general, due to inaccurate calculations of future consumption, there proved to be considerable difficulty in choosing appropriate prices and proportions for old and new wool. It is of interest to note that the Joint Organization does not propose to establish similar rigid proportions between sales of old and new wools, but retains complete freedom to vary offerings of old wool according to the demand and supply situation at any given time.

During the first year of the Association's operations, there was a general slump in the wool market and prices were low. There was, however, a comparatively strong demand for higher priced wools and Bawra was consequently able to sell 1,461,679 out of the 3,352,057 bales on hand in the first year. As the higher priced wool stocks diminished, more of the inferior types were taken, and it will be noticed from the table below that by the end of 1922, prices for crossbred wools were beginning to rise. The table also reveals substantial differences in the price levels of periods before and after the existence of Bawra as compared with the four years of its operations. During the period January 1921 through April 1924, with the exception of the initial slump, prices were maintained at fairly stable levels.

PRICES OF WOOL PER POUND

	July 1914	March 1920	April 1921	May 1922	Oct. 1922	Dec. 1922	Dec. 1923	Dec. 1924
Super fleece	32d	165d	40d	60d	66d	61d	66d	85d
Good pieces	28	130	28	45	60	55	60	73
Crossbreds	26	86	21	30	36	37	44	57
"	17	42	10	15	15	17	21	35

During its brief existence, Bawra was able to sell 9,895,000 bales of Colonial wool (both old and new) for 380 million pounds sterling at a profit of 70 million pounds. Throughout the period, the financial position of the Association was exceptionally liquid.

Slight Improvement in the Philippines

J.H.F.

In recent months, the cost of living in the Philippines (see this Review, August 27, 1945) has been stabilized, and even slightly reduced. At the end of August, monthly living expenses of a family of six in Manila were estimated at 770 pesos (385 dollars), about 10 per cent lower than at the end of July, but still ten times as high as before the war and quite out of line with the earning power of the average Filipino. A few examples of specific prices may be cited. Onions had virtually disappeared from the market and were quoted at 153 times their pre-war value; sugar was sold at 25 times, fish at 23 times their pre-war prices. The fall in the average price level was due primarily to the expectation of increased imports from the United States as the result of the end of the war in the Pacific. Government control of supply conditions still appears to be almost nil. Distribution of rationed foodstuff at official prices actually declined in August by about 20 per cent. Sugar continues to be diverted to distilleries, and the legislature has taken no action upon a proposal to prohibit such diversion. The clothing situation is particularly bad. The small quantities of cloth distributed through Government stores are being immediately resold by purchasers at large profits, and a regular market is reportedly being conducted in Army clothing, purchased illegally by civilians from individual soldiers. The Philippine National Bank, and some other domestic banking institutions, have been reopened, but the overall economic rehabilitation of the country is still in its very first stage.

Inflation in Hungary J.H.F.

The Hungarian National Bank has issued its first statement since the fall of 1944. The statement reveals that the note circulation rose from 1 billion pengö on December 31, 1939, to 11 billion on November 30, 1944, and 42 billion on September 30, 1945. According to newspaper reports (New York Times, October 17, 1945), a further rise by about 1 billion per day has been taking place in October. Hungarian observers compare the present situation to that existing after the first World War at the end of 1922, when the note circulation increased to about 170 times and the price level to about 540 times the pre-war level. At present, the reported note circulation (which does not include currency issued by the Red Army) is only about 50 times as high as before the war, but the black-market rate of the dollar reportedly has reached about 4,000 times the pre-war parity (20,000 pengö per dollar, as compared to about 5 pengö in 1941 and 150 pengö in April 1945). Domestic purchasing power of the pengö has not dropped so fast as its foreign exchange value with the result that prices appear to be "only" about 500 to 1,000 times as high as the pre-war level. Wages have, as usual, lagged far behind prices, and in spite of a recent increase by 50 per cent, appear to be less than 100 times the pre-war figure. The real income of wage earners has thus been drastically reduced. As a measure of relief for consumers, the Government contemplates the unblocking of savings deposits up to 10,000 pengö (50 cents at the present black-market rate).

On September 20, 1945, the stock exchange was reopened for limited business, but because of a sharp rise in share quotations, was closed again on October 12. This gesture has been the only anti-inflationary move undertaken thus far by the Government and the Russian occupation authorities.