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Board of Governors of the Federal Reserve System
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The Devaluation of the Axis Currencies

Hans J. Dernburg

Allied military lira currency has been used in occupying Italy, and, in the process of conquering Germany, Allied military mark currency is presently being issued by both the Allied and the Russian armies. It was recently announced that American forces in conquering the Japanese Ryukyu Islands introduced military currency in terms of yen. The exchange rate was established at 10 United States cents to the yen. The Ryukyu Islands belong to Japan proper and it can therefore be assumed that the rate will be adopted for Japan in general. Since a lira and a mark rate had been previously established, it is now possible to compare the degree of devaluation of the three major Axis currencies.

	1940 Average rate in New York	1945 Allied occupation rate
	(U. S. cents)	
1 mark	40.02	10
1 yen	24.43	10
1 lira	5.04	1

It is obvious that the objective of devaluing the currency of the enemy was combined with the practical one of arriving at some rate which facilitates conversion for Allied paymasters. In the three countries military currency in terms of the local monetary unit (mark, yen, lira) is being issued, and expenditures, though budgeted in dollars, are paid out in local currency. Computation is easiest, of course, when the dollar is worth ten times or 100 times as much as the foreign currency because conversion then simply means moving the digit. From the above rates it is obvious that the arithmetical point of view has had a decisive influence on the degree of devaluation which amounted for

the mark to 75 per cent
" yen " 57 " "
" lira " 80 " "

It has been generally assumed that the yen was considerably undervalued in the years preceding the war with China (which began in 1937). Price rises during the conflict, however, tended to correct the undervaluation and it is very likely that in 1938-39 the yen rate represented about the "equilibrium rate". At that time the German mark was overvalued by about 30 to 40 per cent. Since then the price level has continued to rise in both countries. Compared with the first six months of 1939, the Japanese cost of living index stood at 155, in November 1944, and the German cost of living index at 112. As a result of these developments, the nominal ratio between yen and mark of about 2 to 1 which used to prevail between the two currencies may be assumed to reflect the present actual ratio of their purchasing power.

By giving both the mark and the yen the value of 10 cents, the Allies established parity between the two currencies, thus almost doubling the value of the yen in comparison with that of the mark. The newly established rates are, of course, preliminary, and will be changed depending on the degree of post-war inflation. It seems, however, that the yen has a more favorable start than both the reichsmark and the lira.

Exchange Rates and Prices in Hungary C.B.R.

Fragmentary information which has just become available indicates the development of a marked degree of inflation in Hungary. Two articles the prices of which usually lag in a period of rising costs are newspapers and milk. At the present time, daily newspapers in Hungary are sold for 60 filler (one pengő = 100 filler) compared with 20 filler before the war, and 30 filler in the fall of 1944. New ceiling prices for dairy products in the Debrecen area set in March 1945 are compared with official prices in Budapest in March 1941 in the table below. It should be noted that normally food prices in the provincial town of Debrecen would be lower than in the capital city of Budapest.

Commodity	March 1941	March 1945
	(Pengő)	
Whole milk, 1 liter	.34	2.60
Cream, 1 kilogram	--	14.00
Sweet butter, 1 kilogram	4.20	56.00
Pot cheese, 1 kilogram	.60	14.00
Sheep cheese, 1 kilogram	2.80	26.00

No exchange rate between the dollar and the pengő has yet been fixed. The official exchange rate in terms of ruble has been set at 1 ruble = 2.50 pengő, which gives a cross-rate of $1 = 13.3 P or 1 P = 7.5 cents. This represents a devaluation of 62 per cent from the last dollar quotation of the National Bank of Hungary for August 1941 when the pengő was officially worth 19.76 cents. There are indications that the actual rate at present for the dollar is 150-200 pengő per dollar.

The Significance of British Financial Agreements Lloyd A. Metzler

The financial agreement which the United Kingdom made with France on March 27th is the third in a series of accords which the British have been negotiating with other European countries. Together with similar Swedish[1] and Belgian agreements, it provides an indication of the direction of British post-war foreign economic policy. While the full details of the latest agreement have not yet been published in the United States, its principal features are clear from newspaper and trade journal accounts.

Like the agreements of the United Kingdom with Sweden and Belgium, the Anglo-French agreement stabilizes the rate of exchange between the two countries and provides for temporary credits to meet any discrepancies between supply and demand for each others' currency. The rate of exchange is fixed at 200 francs to the pound sterling, and each country grants the other credits equivalent to 100 million pounds. The credits are extended until March 1, 1946, when an accounting will be made. If the accounting shows that the French are indebted to the British, on balance, the former have agreed to settle by making gold payments equal to one-third of the value of their current imports from the United Kingdom. If further payments are necessary, the French have agreed to draw upon their private sterling cash balances.

If the accounting shows that the United Kingdom is indebted to France, the former country has agreed to make payments on the same gold basis; that is, gold payments are to be made equal to one-third of current purchases from France. The balance is to be carried over.

The agreement necessarily involves a certain amount of exchange control. Sterling accounts of residents of the French area included in the agreement will be segregated and will be available only for payments within the sterling area or for transfer to other French accounts. The foreign exchange proceeds of all exports from the United Kingdom to the French franc area will be placed in these segregated accounts. All French currency held by residents of the United Kingdom must be offered for sale to the United Kingdom.

Whether this arrangement will result in a bilateral clearing system or not depends largely upon future developments. If the annual settlement of accounts through gold and foreign exchange transfers is complete, there will be little difference between the plan contemplated in the agreement and a multilateral system. But if part of the claims are carried over from year to year, a plan must ultimately be devised for settling this unpaid balance. It would not be surprising, under these conditions, if attempts were made to balance the British-French trade bilaterally.

Unlike the Swedish agreement, the French agreement is expected to create a claim by the United Kingdom against the other party to the agreement. In other words, it is expected that British exports to France during the next year will exceed French exports to the United Kingdom. France has a pressing need for many of the basic

1/ See Review of Foreign Developments, April 2, 1945.

products such as steel and textiles which the United Kingdom customarily exports, whereas the British are not expected to have a large demand in the near future for luxury items such as wine, perfumes, and dresses which France customarily exports.

The agreement was delayed for some time by differences over the means of settling claims arising from a discrepancy between exports and imports. The British felt that while France had suffered internally from the war, her foreign exchange position remained relatively secure, owing largely to the blocking of gold and other French balances in the United States. In contrast, the United Kingdom has used a large part of her gold and foreign exchange resources in prosecuting the war. Under the circumstances, it was felt that the French should use a part of their foreign exchange reserves to finance their expected import surplus with the United Kingdom. The issue was finally settled in the agreement regarding gold payments and use of foreign exchange mentioned above.

The significance of this agreement for British post-war financial and commercial policy is not yet clear. The British Treasury insists that the French agreement, as well as the agreements with Sweden and Belgium, is merely a temporary arrangement, intended to establish an orderly currency system during the immediate post-war years. On the other hand, it would not be implausible to suppose that the agreements with France and Belgium might result, ultimately, in a permanent extension of the sterling area. The striking resemblance between the stabilization and lending features of these agreements and similar features of the Bretton Woods agreements suggests, further, either that the British are dissatisfied with the size of the international monetary fund, and are seeking to expand the system of lending to deficit countries by means of bilateral agreements, or that they feel that the prospects for adoption of the Bretton Woods plan are not sufficiently bright to form the basis for their own post-war monetary policy.

In any case, it is clear that the British will not hesitate to make further bilateral financial agreements to stabilize their currency with the currencies of other countries. It seems probable also that these financial agreements will subsequently be supplemented by bilateral trade agreements, involving commitments by the participating countries to take specified amounts of British exports. By means of such trade agreements, the British will be able to use their potential import surplus as a means of expanding their exports without a deterioration in their terms of trade. The trade agreements, if not the financial agreements, will clearly conflict with the interest of the United States in establishing a post-war system of unrestricted multilateral trade. The export markets of the United States will no doubt be reduced somewhat by such bilateral trade agreements.

From this point of view, the financial agreements are a straw in the wind, indicating the probable direction of British post-war international policy. Unless the United States shows a greater willingness than has been shown to date to solve the international financial problems of other countries in a cooperative manner, it seems highly unlikely that the United Kingdom will abandon her bilateral arrangements in the field of commercial policy. Moreover, the longer the delay in the establishment of a clear and unequivocal American policy, the more firmly will bilateral dealing become entrenched, and the more difficult it will be to set up a truly multilateral system.

Post-war Problems and Policies in Switzerland

Rosa Ernst

Swiss export trade prospects after the war have been the subject of much discussion in that country. According to one view, their future will be favorable only under conditions of international free trade and a liberal Swiss policy in regard to imports. The kind of credit arrangements possible, the degree of exchange control, and the character of trade policies of other countries would be the most influential factors affecting Swiss exports. On the other hand, there are those who believe that reliance should be placed on national policy designed to strengthen the position of Swiss exporters who will encounter increased competition in world markets. This would require adjustments in the domestic economic structure. The direction of authoritative Swiss thought is indicated by a report of a parliamentary committee on plenary powers in Switzerland which was charged with preparing for the Federal Government an outline on post-war economic and monetary policies with special reference to questions concerning supplies, prices, wages, and the currency. The committee based its conclusions on surveys made by several official and semi-official agencies. The most important of its recommendations are summarized below.

Price Policy

Special attention is to be paid to the internal price and wage structure since the ultimate objective of Government price policy is the stability of the price level. One of the most important tasks is to bring about a reduction in prices. If necessary, price equalization funds and Government subsidies are to be established for this purpose.

Prices are to be based on costs prevailing under normal competitive conditions. Increases due to capital outlay and additional production costs are to be taken into consideration in formulating prices but only to the extent to which the increase in these items cannot be absorbed by economies elsewhere, and only if war-time reserves are not sufficiently large to permit the industry to bear the higher cost. The Price Control Office is to see to it that prices are lowered in instances where war-time investments have been amortized to an unusual degree.

If costs rise because of a smaller turnover, a certain part of such costs is to be borne by the industry. The authorities will prevent excessive trade margins, especially on daily necessities, in order to achieve a proper balance between producer and consumer prices. In establishing prices, taxes on income and capital may not be taken into consideration, but allowances are to be made for customs duties, costs of transport, and consumption taxes.

The quantity and quality of every-day consumer goods are to be increased and improved after the war and their proportion in total production expanded. Consequent redistribution of costs must not place a burden on necessities but if a reduction in price can be secured through mass production, the industry concerned may be allowed a compensatory increase in the price of luxury articles. In case of price differences between imported and domestic goods, an adjustment is contemplated by means of Government subsidies, if necessary. Imports of goods at unduly high prices may be prohibited.

If an increase in industrial production is desirable and can only be achieved at higher real costs, or if the maintenance of this higher production level causes additional costs, then such costs may be compensated for, by means of equalization funds, but in general raising prices to the level of the highest unit production costs will not be permitted. The operating costs of a well-organized enterprise functioning under normal financing and employment conditions are to serve as a standard for determining the average operating costs of certain types of production. Private initiative is to be encouraged in helping to maintain price stability. Government subsidies should be resorted to in compensation for an increase in the price of daily necessities due to a rise in production costs or purchase prices, but at no time should the ultimate consumer have to bear the burden of such an increase. In the interest of quick results and cooperation between private economy and the Price Control Office, industry is to be given a chance to make suggestions leading to the lowering of prices.

The sphere of action of the Price Control Office will be extended to all commodity prices to the extent to which the Government intervenes in the production or marketing of these commodities, as well as to all types of remuneration for services. A uniform system of cost calculation is to be set up by the Price Control Office in all branches of production.

Finally, complete coordination is to be sought between the price and wage policy and financial policy.

Monetary Policy

Monetary and credit policy in the post-war economy should, according to the report, be designed to avoid a deflationary trend with the resultant credit restrictions. However, if cheaper import prices can be instrumental in lowering domestic production costs, monetary measures and trade policy should not be allowed to interfere with a drop in commodity prices. Moderate and stable interest rates are to be maintained by the National Bank.

Export risk insurance and the export of capital are to serve the interests of export trade and the country's supply of raw materials. Exchange rate adjustments probably will be made solely on the basis of international agreements and within narrow limits only, but full employment will be considered more important than a rigid monetary policy.

An attempt is to be made to foster relative stability of the internal purchasing power of the franc through appropriate measures in the monetary field applied in connection with the stabilization of the national economy as a whole. It is desirable to re-establish the pre-war real wage level in order to increase the purchasing power of the workers. To this end a rise in nominal wages should be achieved through a lowering of the cost of living. The ultimate goal is to be a minimum wage for all wage-earners.

As a general conclusion, the report of the parliamentary committee acknowledges that the questions relating to prices, wages, and the currency cannot be solved independently, but must be considered within the framework of a general economic post-war program.

The German Gold Holdings

Hans J. Dernburg

The recent discovery of a German gold hoard of some 100 million dollars in the Merkers salt mine has drawn attention to the German gold holdings, which since 1936 have been shrouded in secrecy. Since that time, they have been reported practically unchanged in the Reichsbank statement at the equivalent of some 29 million dollars, a purely nominal figure. In the table on the following page, the gold now held in Germany has been estimated at 570 million dollars or, excluding the holdings on account of Italy and Hungary, at some 450 million dollars. The figures are estimates based on preliminary and incomplete data and may be modified as further details become known.

Even before the war the German gold reserve was considerably increased through secret additions and by absorbing the gold of the Austrian National Bank and a part of the gold of the Czechoslovak National Bank apportioned to the Sudetenland. After the establishment of the Protectorate in March 1939, the Germans endeavored to get hold of the remaining gold of the Czechoslovak National Bank held in England (partly as an earmarked account of the B.I.S. for the Czechoslovak National Bank), but none of this gold seems to have been physically transferred to Germany.

The Polish campaign did not add to the German gold holdings. That part of the Polish gold reserve which had been held in the country (some 65 million dollars) had been removed from Poland in September 1939, and had landed, after a dangerous Odyssey, in French West Africa. It was believed to have been delivered by Vichy-France to Germany, but after the Allies invaded Africa in 1942 it was found to be intact. The Norwegian gold was evacuated to England in April 1940.

The largest gold acquisitions were those from the Netherlands and France. Most of the Netherlands gold handed over to the Germans represented a "voluntary contribution" of the Netherlands to the war against the "common enemy" in the East. Under German pressure, Belgian gold in an amount of 223 million dollars held by the Bank of France for the Belgian National Bank had been delivered by the Bank of France to the Germans. After the liberation of France, the Bank of France indemnified the National Bank of Belgium in December 1944 by a corresponding amount in gold. To the 223 million dollars which France lost in this way should be added another 50 million dollars which the Germans seized at Clermont-Ferrand when they crossed the demarcation line in late 1942.

Gold Held in Germany
(Preliminary figures)

		Millions of dollars	
Holdings at outbreak of war			
Reported holdings		29	
Estimated secret additions since 1936		86	
Austria		46	
Czechoslovakia		16	
	Total	177	
Acquired since outbreak of war			
Danzig		4	
Poland		0	
Denmark		0	
Norway		0	
Netherlands		142	
Belgium		0	
France		273	
Yugoslavia		0	
Greece		0	
	Total	419	
Held for other Axis powers			
Italy		100	
Hungary		25	
	Total	125	
Holdings at outbreak of war plus acquisitions			721
German gold exports since outbreak of war			
Rumania		- 40	
Greece		- 8	
Slovakia		- 2	
Estimate for exports to neutral countries		-100	
	Total		-150
Net holdings			571
Net holdings excluding those for Italy and Hungary			446

After the Allied advances in Italy, the gold reserves of the Bank of Italy, amounting to 120 million dollars, was moved to Germany in September 1943. About 20 million dollars out of that sum was transferred to Switzerland in January 1944, in settlement of certain Italian obligations. After the Russian successes in Hungary, the Hungarian gold reserve, amounting to 25 million dollars, was moved to Germany in November 1944. The Germans probably consider these Italian and Hungarian gold holdings not as acquisitions, but as deposits taken into custody in order to prevent seizure by the Allies.

Most difficult to estimate are the amounts of gold exported by Germany during the war. Certain gold exports to Rumania, Slovakia, and Greece have been reported, but practically no data have become available on the possibly important gold exports to neutral countries such as Switzerland, Sweden, Portugal, Spain, and Turkey. Transfer of gold from Germany to Turkey has been facilitated by the fact that in Turkey the gold market is free and considerable amounts may have found their way to private holders in that country. Gold movements to Portugal were also reported to be sizeable, one estimate of March 1943 putting them at 100 million dollars, but such an amount is probably excessive. In our opinion, this figure would be a conservative estimate of the total exports to all neutral countries.

New Taxation Trends in Latin America

Paul Vinelli

Personal and corporate income taxes have been in existence in Latin America for a considerable length of time. Chile, Colombia, Brazil, and Bolivia all had instituted direct taxes prior to 1924. Indeed, Bolivia instituted a corporate income tax as far back as 1886. Nevertheless, in the past, income taxes have always played a relatively minor role in the tax structure. Import and export duties--particularly the former--provided the chief source of revenue for the countries of Latin America. During the war, however, income taxes have supplanted customs duties as the chief source of government revenue. The gains in income tax revenue reflect not only larger individual and corporate incomes, but also higher tax rates, lowered exemptions, and the development of improved tax machinery.

In the mid-1920's the ratio of customs duties to total Government revenues was 47 per cent for Argentina, 70 per cent for Paraguay, about 50 per cent for all of Central America, Uruguay, Colombia, Chile, and Venezuela, 45 per cent for Bolivia and Peru, 39 per cent for Ecuador, and 33 per cent for Brazil. This heavy dependence upon customs duties has followed from two factors: (1) the tremendous importance of foreign trade in the economic life of these countries; and (2) the relative ease of collection of such revenues.

The impact of the war has forced a change in the traditional fiscal structure. Imports have fallen drastically in volume. As a consequence, customs duties have tended to dry up. On the other hand, exports have risen to new high levels. There has been a large accumulation of international reserves and a consequent increase in the money supply which has exerted serious inflationary pressure on domestic price levels.

Faced with this paradox of heavy budgetary deficits in the middle of unprecedented prosperity, the governments have turned to alternative sources of revenue, especially income taxation. Heavier income taxation was advisable first because the swollen incomes, particularly those of exporters, offered a large alternative source of revenue, and, secondly, because the increase in income taxes has had an anti-inflationary effect. Equally desirable, and from some points of view even more desirable, would be a sharp increase in land taxes. An increase in land taxes would provide large amounts of revenue, would combat inflation, and would also tend to produce both a more equitable distribution and a more intensive utilization of the land. The political strength of the large landowners has been so great, however, that there has been no significant increase in land taxes.

Argentina has seen her customs receipts dwindle from 377 million pesos in 1938 to 192 million in 1942, and then to 108 million in the first eleven months of 1944. In 1942, however, receipts from income taxes rose to 198 million pesos and exceeded customs receipts for the first time in the nation's history. By 1944, income tax receipts netted 373 million pesos during the first eleven months of the year, and were nearly four times larger than customs revenue.

Similarly, Colombia's levies on foreign trade yielded 31 million pesos in 1938, only 19 million in 1942, and 20 million during the first ten months of 1944. On the other hand, revenue from income taxes, which was only 18 million pesos in 1938, mounted to 28 million in 1942 and became by far the most important single source of revenue.

Brazil experienced the most drastic decline in customs receipts--from 1,052 million cruzeiros in 1938 to 596 million in 1943. Brazil also, however, displayed the most spectacular gains in income tax collections. Receipts from this source totaled 263 million cruzeiros in 1938, more than tripled by 1942 (978 million cruzeiros), and reached a record level of 1,961 million cruzeiros in 1944.

Tax Revenues

Argentina
(Million pesos)1/

	1933	1935	1937	1938	1939	1940	1941	1942	1943	1944*
Total taxes	747	788	945	934	950	896	839	885	887	1,180
Customs receipts	307	324	406	377	321	271	217	192	127	108
Income tax	65	77	100	108	112	126	127	198	260	373

1/ The Argentine peso equals approximately U.S. $0.26.
* First eleven months.

Colombia
(Million pesos)1/

	1933	1935	1937	1938	1939	1940	1941	1942	1943	1944*
Total receipts	39.8	57.4	82.6	84.4	91.6	78.0	81.8	77.0	78.5	72.8
Customs receipts	22.3	27.5	34.3	31.1	40.6	27.7	30.5	18.7	21.7	19.1
Income, property, and excess profit tax	1.7	4.4	15.6	18.2	19.4	22.0	22.2	27.5	26.0	24.3

1/ The Colombian peso equals approximately U.S. $0.57.
* First ten months.

Brazil
(Million cruzeiros)1/

	1933	1937	1938	1940	1941	1942	1943	1944
Total taxes	2,078	3,462	3,879	4,036	4,046	4,377	5,443	2/
Customs receipts	756	1,173	1,052	977	1,059	674	596	2/
Income taxes	123	232	287	411	537	988	1,498	1,961

1/ The Brazilian cruzeiro equals approximately U.S. $0.05.
2/ Not available.