CONFIDENTIAL

RFD Mr. Wheeler

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

REVIEW OF FOREIGN DEVELOPMENTS

April 30, 1945

Editors' Note

The concensus among readers, as expressed in response to the questionnaire distributed in March, is that the general character of the Review as developed to date should be continued. A suggested innovation, however, is that the pages of the Review be opened to communications from readers who may disagree with interpretations expressed or implied in published articles. The editors welcome this suggestion and will consider for publication appropriate communications of this nature as well as original contributions dealing with subjects within the scope of the Review.

....

Recent European Financial Agreements and the International Monetary Fund

Alice Bourneuf

In the last issue of this Review, Mr. Metzler discussed the significance of recent British financial agreements, emphasizing the probability that they forecast financial practices or trading agreements designed to balance trade between the countries concerned. A brief analysis of the relationships between the financial agreements and the proposed International Fund indicates that, as Mr. Metzler's article would suggest, the most important of the possible conflicts between the two systems will arise if exchange restrictions are used as a means of trying to balance trade between the countries concerned. In a broader sense, bilateral trading arrangements would of course also be fundamentally contrary to the objectives of the Fund. Other possible conflicts of a more technical nature are of less importance.

But each of the bilateral agreements states that it is not intended to be prejudicial to the adoption of a broad international stabilization arrangement, and that if such an arrangement is adopted the particular bilateral agreements will be reviewed from the point of view of securing harmony. It is interesting therefore to examine the possible inconsistencies in some detail. Similar problems arise in connection with less formal arrangements, for example, those of the whole sterling area before the war.

Since October 1943, financial agreements have been contracted by the United Kingdom with Belgium, Sweden, France, and others, by Belgium with Holland and France, and by France with Switzerland. These agreements fix the rate of exchange between the currencies of contracting countries, provide for changes in rates only after consultation or agreement, and obligate the monetary authorities of the parties to the agreement to accumulate each other's currency to facilitate payments between the two monetary areas.1/ With one exception, the size of the balances to be accumulated under the agreements is more or less definitely fixed2/ and further balances must be settled in gold. The amounts involved are less than 50 million dollars except in the case of the United Kingdom-France agreement which sets a limit of roughly 400 million dollars (at current exchange rates). The Anglo-French agreement differs also in that an accounting must be made as of March 1, 1946, and complete settlement must be made in gold or sterling if France is indebted to the United Kingdom.

The first impression is likely to be that the financial agreements necessarily involve the maintenance of restrictions on current transactions or of discriminatory currency practices such as can not be adopted under the Fund agreement (except for special transitional period arrangements) except with the approval of the Fund. This is not the case however. The supervision and control of exchange transactions necessary to the implementation of the agreements are such as may be classed as restrictions on capital transfers which are freely permitted under the Fund agreement.

In fact, the countries which have so far entered into these bilateral financial agreements will probably join the Fund under the special transitional period arrangements and will therefore be allowed to maintain and adopt the exchange restrictions and currency practices in force at the time of joining the Fund. Insofar as restrictions are tightened or maintained with a view to achieving balanced trade between countries having bilateral financial agreements, the existence of those agreements will delay the removal of such restrictions. Under the transitional arrangements, it is true, members promise to remove such restrictions as soon as they find it possible. But the bilateral agreements will in fact make this more difficult because of the building up of vested interests, the credit obligations involved, and defensive measures adopted by third countries.

1/ The monetary area in the case of the United Kingdom includes the whole sterling area. This raises a number of problems, among them the question of how large sterling balances some members may be willing to accumulate.

2/ It is understood that even in the case of the one exception an informal understanding as to the limit has been reached.

If countries join the Fund without taking advantage of the transitional arrangements, any exchange restrictions or discriminatory currency arrangements can be adopted only with the approval of the Fund, and any discriminatory currency arrangements in force at the time of joining must be progressively removed. Any bilateral financial agreements, therefore, entered into by such countries could not lead to the adoption of restrictions designed to achieve bilateral balancing of trade, unless such restrictions were approved by the Fund.

Three points of lesser importance may be considered:

(a) The provisions for changes in exchange rates only after consultation or agreement seem to be somewhat inconsistent with the spirit, if not the letter, of the Fund proposal. The gold value of the Belgian franc, for example, cannot be changed under the Fund plan except on the proposal of Belgium. It is possible for Belgium, therefore, to live up to her agreements with the Netherlands, France, and the United Kingdom by not proposing any change in the value of the franc without their approval. Conceivably though, Belgium and the Netherlands might apply for similar changes in par value and the Fund might be willing to approve in one case and not in the other. More important, the Fund might recommend that Belgium alter the gold value of the franc and the change might meet objections on the part of France, the Netherlands, or the United Kingdom.

(b) Certain difficulties may arise in connection with the repurchase provisions of the Fund. These complicated provisions require members to use their reserves of gold and "convertible" currencies at the same rate that they draw on the Fund and to use half of any increase in these reserves, provided the Fund's holdings of the "convertible" currencies are low, to buy back their own currencies from the Fund, i.e., to reduce their indebtedness to the Fund. "Convertible" currencies are the currencies of those members which have not taken advantage of the special transitional arrangements.

The possibility arises that Belgian monetary authorities, for example, might be accumulating sterling balances in accordance with their obligations under the financial agreement with the United Kingdom and yet be obligated under the Fund agreement to turn part of those balances over to the Fund.

There are several reasons for believing such a conflict of obligations will not arise. First, Belgium could probably avoid the difficulty by repurchasing its currency from the Fund with gold. Second, the currencies held under the bilateral agreements contracted to date will probably all be currencies which are not "convertible". Third, the currencies held under these bilateral agreements are likely to be currencies the Fund's holdings of which are not low because they are likely to be currencies of countries which are in a weak balance of payments situation and therefore drawing on the Fund.

There is one way, however, in which the Fund repurchase provisions may affect the bilateral financial agreements. A country which is increasing its holdings of "convertible" currencies is obligated to make certain repurchases from the Fund. Even though some of the currencies acquired are not acceptable to the Fund, the amount of repurchases required will be affected by their acquisition. It is conceivable, therefore, that countries joining the Fund will be less willing to accumulate balances of weaker convertible currencies because such accumulations would require them to hand over some of their stronger foreign currency holdings to the Fund.

(c) One further possible difficulty may be mentioned. Assume that the United Kingdom is drawing on the Fund and at the same time is accumulating large franc balances under its agreement with France. The management might refuse further assistance to the United Kingdom on the ground that it was using the resources of the Fund to meet a large or sustained outflow of capital. The United Kingdom would in essence be borrowing from the Fund and at the same time lending to France. Since the amounts involved in most of the agreements are very small and the United Kingdom-France agreement (which alone involves large sums) provides for complete settlement of any French indebtedness to the United Kingdom on March 1, 1946, this is not likely to be a serious problem unless much larger commitments are made in future agreements.

Belgian Expenditures for the Allied Armed Forces J.H.F.

The statement of the National Bank of Belgium for March 22, 1945, has included for the first time since January 11 a complete breakdown of its advances to the Government. During this period of ten weeks, total advances increased by 7.0 billion francs; only 0.7 billion were used for covering ordinary government expenditures, however, while 6.3 billion were needed for advances to the Allied armed forces and for "mutual aid" expenditures. During the same period, demand liabilities (currency and deposits) increased by 8.0 billion francs; of this sum, 2.0 billion resulted from the unblocking of frozen balances. The rise in liabilities is smaller than the increase in advances to the Government would suggest, because of a considerable decrease in advances upon Government securities, mainly to credit institutions. According to the statement of March 22, advances to the Allied armed forces totalled 10.8 billion francs, and advances for "mutual aid" purposes 4.2 billion. Surprisingly enough, advances to the armed forces declined by 1.8 billion francs between March 15 and 22; since at the same time foreign exchange balances increased by 1.4 billion, this fall may be due in part to repayment of advances by one or the other of the Allied powers. In any case, the recent breakdown shows that contrary to the picture presented by the first bank statements[1/] issued after liberation, the expansion of the Belgian currency at present is due only to the requirements of the Allies rather than to the government deficit. Since the needs of the Allies will diminish rapidly, the danger of a violent inflation seems to be averted for the time being.

1/ See Review of Foreign Developments, February 5, 1945, page 6.

Government Finance in the Third Reich

Paul Hermberg

During the period of rearmament from April 1933 to August 1939, total receipts and borrowings of the administration of the Reich, the German States, and Municipalities amounted to RM 166 billion. The borrowings include the so-called secret debt of the Reich, which amounted to RM 12.6 billion in April 1938. About RM 111 billion of the total receipts were used for civil purposes (including about RM 9 billion of World War I charges). The remaining RM 55 billion were spent for rearmament. This is a direct contradiction of the boast of Hitler on the day of the attack on Poland that the Third Reich had spent RM 90 billion for rearmament. Admittedly the estimate of RM 55 billion involves some margin of error but it is very small in relation to the total amount of expenditures and no greater than 10 per cent in relation to the civil charges. Even if private spending and investments in war industry were included, the rearmament outlay would not reach the neighbourhood of RM 90 billion.

Government Finance in the Third Reich
Period of Rearmament

	1933-1934	1934-1935	1935-1936	1936-1937	1937-1938	1938-1939	April 1939 to Aug.1939	Total
	(Billion RM)							
Receipts and borrowings								
Receipts	14.1	15.5	17.3	19.5	23.4	28.0	14.1	131.9
Borrowings	1.6	1.3	4.3	4.6	6.2	10.6	5.5	34.1
Total	15.7	16.8	21.6	24.1	29.6	38.6	19.6	166.0
Expenditures								
Civil charges	13.1	13.7	14.2	15.6	18.0	19.4	8.4	102.4
World War I charges	1.6	1.6	1.5	1.4	1.2	1.0	.4	8.7
Rearmament charges	1.0	1.5	5.9	7.1	10.4	18.2	10.8	54.9
Total	15.7	16.8	21.6	24.1	29.6	38.6	19.6	166.0

During the war (from September 1939 to March 1945), total receipts and borrowings reached RM 676 billion, of which RM 120 billion came from foreign sources. About RM 207 billion were spent for civil purposes, of which, however, RM 36 billion were for World War I charges and allowances for soldiers' families. The balance of RM 469 billion remained for direct war expenditures. Consequently, about 18 per cent of total government expenditures or about 25 per cent of direct war expenditures were financed by foreign countries, including the Protectorate but excluding territories officially incorporated in the Reich.

The tables show that nearly three-fourths of the total expenditures were spent for war purposes compared with about one-third of the total which went for rearmament in the pre-war period. In order to appreciate the extent to which governmental expenditures, and more particularly the costs of rearmament and war, have burdened the German economy, comparison should be made with the national net output and the national income of the country. A separate investigation of this question is now being carried out.

Government Finance in the Third Reich
Period of War

	Sept.1939 to Mar.1940	1940-1941	1941-1942	1942-1943	1943-1944	1944-1945	Total
Receipts and borrowings	(Billion RM)						
From domestic sources							
Receipts	22.0	40.9	48.6	58.7	50.7	50.0	270.9
Borrowings	12.2	32.2	42.9	42.7	61.1	94.2	285.3
Total	34.2	73.1	91.5	101.4	111.8	144.2	556.2
From foreign sources							
Contributions	.3	5.9	10.7	15.6	20.7	19.8	73.0
Borrowings	.7	4.0	7.9	11.1	13.2	10.3	47.2
Total	1.0	9.9	18.6	26.7	33.9	30.1	120.2
Total receipts	22.3	46.8	59.3	74.3	71.4	69.8	343.9
Total borrowings	12.9	36.2	50.8	53.8	74.3	104.5	332.5
Grand total	35.2	83.0	110.1	128.1	145.7	174.3	676.4
Expenditures							
Civil charges	16.0	24.7	29.3	30.4	32.4	38.5	171.3
World War I charges	.5	.8	.7	.6	.6	.5	3.7
Allowances for soldiers' families	2.0	4.5	5.0	6.0	7.0	8.0	32.5
War expenditures	16.7	53.0	75.1	91.1	105.7	127.3	468.9
Total expenditures	35.2	83.0	110.1	128.1	145.7	174.3	676.4

Rumania Issues Gold Coins M.M.M.

An "interesting if true" report has come from Brussels to the effect that Rumania has joined the list of countries endeavoring to check inflation by the issue of gold coins. It is said that 600,000 gold pieces had been minted to be put into circulation beginning February 1, 1945, at a purchase price of 15,000 lei per 1 gold louis. The gold content of the new coin was not specified but assuming that it is the 20 franc piece of the old Latin Monetary Union the paper lei in terms of gold would have a value of 0.0436 U.S. cent, or about 4-1/3 cents for 100 lei. Last September, when the Soviet armies occupied Rumania, a rate of 100 lei to the ruble was established. The Moscow-New York rate of the latter has been pegged since 1937 at 18.87 U.S. cents. Figured by the cross-rate, the paper lei then had a nominal value of 0.1887 U.S. cent, more than four times as much as the gold rate given above. Such a gold premium is not abnormal under present day conditions in Continental Europe. Continuing inflation is indicated by the last available figure for the note circulation of the National Bank of Rumania which was 316.2 billion lei on December 31, 1944, as compared with 249.3 billion in September 1944 and 61.4 billion in November 1940 when the Germans took over the country.

The reported gold reserves of the National Bank of Rumania would be ample for issuing these coins, which require about 4 million dollars worth of bullion. The Bank statements show an increase of 109 million dollars during the German occupation, from 157 million in November 1940 to 266 million in September 1944. The figure remained unchanged as of November 4, 1944, the latest date available. Such an increase is not improbable although we may be permitted to question whether the events of the war have not effected the sequestration of the reserves by one side or the other. The country normally has a small gold production, about 5 million dollars a year.

Currency Problems in Liberated Yugoslavia J.H.F.

The currency situation in Yugoslavia is chaotic. When the country was dismembered after the Axis invasion of 1941, the German-dominated administrations of Serbia and Croatia issued separate currencies, called dinar and kuna, respectively. The currencies circulated at par with the old Yugoslav dinar, which before the war had been quoted officially at about 2.3 U.S. cents, and in the "free market" at 1.8 cents, and of which substantial amounts remained in use. In the areas incorporated into Germany, Italy, Hungary, Bulgaria, and Albania, the currencies of the annexing countries were put into circulation. After the beginning of the campaign of liberation, limited amounts of British military pounds appeared. The armies of the National Committee of Liberation and the Soviet forces fighting on Yugoslav soil presumably used means of payment of their own, but no information on this subject is available.

The newly constituted Yugoslav Government announced on April 19, 1945, the issue of a new "dinar of Democratic Federal Yugoslavia", which will replace all other currencies. The new dinar will be equal to 20 Serbian dinars, 40 Croat kunas, 3-1/3 Italian lire, 1 Hungarian pengő, 10 Bulgarian leva, or 0.4 Albanian franc. Exchange of these currencies will be permitted up to the equivalent of 5,000 new dinars; regulations concerning treatment of excess holdings and the payment of debts incurred before April 19, 1945, will be issued later. No exchange rates have been set for reichsmarks, rubles, pounds, or dollars. The ruble would be worth 1-1/2 dinars according to the dinar-lev cross-rate, but 2-1/2 dinars according to the dinar-pengő cross-rate. Similarly, the dinar would be worth 3-1/3 U.S. cents on the basis of the dinar-lire cross-rate, but about 12 cents on the basis of the dinar-lev-ruble cross-rate or 7-1/2 cents on the basis of the dinar-pengő-ruble cross-rate.

During the period immediately preceding the issue of the new currency, the dollar was traded in the "free market" at about 3,500 Serbian dinars, while the Yugoslav Government reportedly sought to establish a rate of 2,000 Serbian dinars. These rates indicate a value for the new dinar of about 0.6 cent and 1 cent, respectively. It is impossible to decide which of these rates, if any, corresponds to the relation of Yugoslav and world market prices because the bulk of commerce is now conducted on a barter basis.

The Yugoslav Government has estimated the amount of Serbian and Croat currency in circulation at 35 billion dinars and 120 billion kunas. This sum would represent 4.75 billion new dinars, as against a total circulation of about 8.2 billion dinars in July 1939. These figures are not strictly comparable, however. The amount of new dinars mentioned does not include the sum needed for the exchange of reichsmarks, lire, pengő, leva, and francs, and on the other hand does not take into account the fact that, at least for the time being, holdings of more than 5,000 dinars will not be exchanged. Moreover, it refers apparently only to the territory under control of the new Government, which at the time of the announcement included about two-thirds of the entire population.

Report of Swiss National Bank for 1944 R.E.

The annual report of the Swiss National Bank for 1944 published early in January of this year has recently become available. The report shows an appreciable expansion in the balance sheet total which rose by 271 million francs to a new high of 4,869 million, but the rate of increase was smaller than in either 1943 or 1942, when it was 371 and 346 million, respectively.

Contrary to the experience of central banks in most other countries, this expansion is not due to extensive inflationary government borrowing, since the Swiss Government has been able to raise substantial funds in the loan market and thus has resorted to central bank credit only on a moderate scale. For the first time since 1930, the Bank held no Treasury bills in its portfolio at the end of the year. In view of the high liquidity of the money market, neither has the private economy turned to the central bank. The reason for the increase in the Bank's total assets is rather the influx of gold and foreign exchange. The amount of gold held by the Bank at the end of 1944 was 4,554 million francs, representing an increase of 381 million over the end of 1943 (as compared with an increase of 608 million during the previous year), while foreign exchange holdings rose by 19 million francs from 83 to 102 million (somewhat less than in 1943). In the course of the year, the Bank received considerable amounts of gold and foreign exchange, particularly from proceeds of exports, from sales of francs to foreign governments, in payment for goods which had been confiscated or which could not be imported for lack of navicerts, and as remittances to the Red Cross as well as for the maintenance of foreign visitors and refugees. Since the Bank could not dispose freely of such foreign exchange, it was forced to limit its purchases of the dollar proceeds of exports. Consequently, the exchange offerings to the Bank were reduced. In conformity with the policy pursued during former years, the Bank converted much of the foreign exchange acquired into gold. In fact the ratio of gold cover to all sight liabilities at the end of the year was over 99 per cent. A precise comparison with the preceding year cannot be made, since it is quite probable that some amounts of gold and foreign exchange may have been transferred to the gold stock from the item "Sundry assets" which shows a decrease from 100 million at the end of 1943 to 0.2 million at the end of 1944.

The note circulation continued to rise during the year and reached a record high of 3,548 million as compared to 3,048 and 2,637 million in 1943 and 1942 respectively, or an increase of 499 million as compared to 411 and 301 million in 1943 and 1942, respectively. Notes in large denominations (500 and 1,000 francs) outstanding at the end of the year amounted to 36 per cent of the total circulation. This bears out the explanation given in the report that the greater part of this acceleration in the rate of increase is due to hoarding arising from uneasiness because of the proximity of the European war to the Swiss borders and because of new fiscal measures adopted by the Government. It is also probable that foreigners may have acquired sizable amounts of Swiss bank notes. The National Bank endeavored to supply a substitute medium for hoarding by selling gold coins to the market.

CONFIDENTIAL

Economic Relations Between the United States and Near Eastern Countries

J. Herbert Furth

The Near East is going to play an increasingly important role in post-war economic affairs. American interest in this region is due to both the largely untapped wealth of oil and the opportunities for trade with a population as great as that of France. The pre-war poverty of the people has been alleviated by Allied war expenditures and may turn to prosperity when the natural resources of the region are fully exploited.

Politically, the area includes independent countries, the largest of which are Egypt, Iraq, and Saudi Arabia; British possessions and mandates, the most important of which is Palestine; and the French mandates of Syria and Lebanon, the complete independence of which has been recognized by the United States, but not as yet by the French Government. From the point of view of international economic relations, the region is divided into (1) countries belonging to the "sterling area", including Egypt, Iraq, and the British possessions and mandates (Egypt and Iraq are the most important non-British territories forming part of the sterling area anywhere in the world); (2) countries belonging to the French franc area, namely, Syria and Lebanon; and (3) one country with an independent currency, Saudi Arabia. These currency relations have become the major determinants of the foreign economic policy of the countries involved.

The countries belonging to the sterling and franc areas have had their freedom in international transactions severely curtailed. The British possessions and mandates are completely dependent upon the central British authorities for whatever non-sterling exchange they need. In the case of Egypt and Iraq, the British authorities have had to make specific commitments in order to induce these countries to remain within the sterling bloc. The bargaining power of the United Kingdom has been increased, however, by the accumulation of huge sterling debts, estimated at 300 million pounds for Egypt and 200 million for Iraq, resulting from British war expenditures. These countries therefore have a very real interest in preventing the pound from deteriorating in value, and in submitting to whatever regulations may be necessary to defend it. Their situation is similar to that of the creditors of Germany during the 'thirties, when Germany's huge foreign debt proved to be its most effective economic weapon.

Syria and Lebanon are in a like position in regard to France. Their economic relations with France have been disrupted by the war. But the recent French-British agreement, which expressly provides that these countries shall remain a part of the franc bloc, has established a large measure of free trade between the franc and the sterling areas and has thus taken care of the bulk of the countries' foreign commerce. Only Saudi Arabia has no commitments binding it to a foreign currency, and its Government has made shrewd use of its independence.

Another problem common to most of these countries is currency expansion. In the area belonging to the sterling bloc, this development has been the corollary of the accumulation of sterling balances, which serve as "backing" for newly issued bank or government notes. Everywhere the expansion can be traced to Allied war expenditures, whereby the resources of the countries were bought up without being replaced by imports. The situation is to some extent similar to that created by German war expenditures in German-occupied Europe. In both cases, the creation of money based upon military expenditures produced considerable inflationary tendencies, which the anti-inflationary efforts of the local Governments counteracted to only a small degree. The inflationary consequences were the worse, the less efficient the local administration; they were least in British-administered Palestine, and greatest in semi-independent Syria and Lebanon. The Allies endeavored to help the local administrations in combating inflation by the sale of gold, but this attempt had little effect and was given up in the fall of 1944.

The situation is different from the European, however, in that the Allies did not exploit the countries where their armies were stationed. They did not levy occupation costs and therefore did not endanger the budgetary situation of the local administrations. The Allied debit balances represent a reliable promise of post-war redemption. Moreover, the Allies used only a small fraction of the countries' resources and imported the bulk of their needs from abroad. The prices which they paid for local supplies were two or three times higher than in peacetime, and the countries' producers and merchants reaped huge war profits. In addition, the United States extended material help to some of these countries by means of lend-lease shipments. Until recently, this help was confined to British possessions and Saudi Arabia, but in March 1945 master agreements were negotiated with Egypt and Iraq. Finally, the sale of American and British surplus commodities has provided a substitute for increased imports, although for obvious reasons the goods that the Allies want to realize are not always those that the local population needs most urgently.

The financial and commercial relations between the United States and the individual countries forming the Arab region are reviewed below.

1. Egypt

Egypt is by far the most important Near Eastern country. Its trade with the United States used to be larger than that of all other Arab territories together. In 1939, it imported 14 million dollars worth of goods from the United States, and exported 7 million dollars of merchandise to the United States. Its imports had changed little in recent years, but its exports had been far greater in times of prosperity, reaching 13.5 million dollars in 1937, and an average of 30 million annually in 1926-30. During the war, imports from the United States have reached enormous figures since they included shipments for the Allied armies on Egyptian soil. Civilian imports have amounted to an estimated 20 to 25 million dollars, and exports to the United States to about 10 million dollars annually.

The amount of imports from the United States is determined mainly by the quantity of dollars allocated to Egypt by the British authorities. The agreement of January 6, 1945, limits the total sum of non-sterling currency available to Egypt to the equivalent of 41.5 million dollars, plus a maximum of 20.75 million dollars for extraordinary imports of wheat and fertilizers, made necessary by the poor harvest of 1944.[1] Included in the limit are payments of 6.2 million dollars for capital charges, travel, etc., and a margin of 4.15 million dollars to cover price increases, omissions, and errors. Since it is considered unlikely that the extraordinary imports will reach the limit, and the "margin" cannot be used for purposes other than those expressly stated, it may be assumed that total imports from non-sterling countries will not be much larger than the basic figure of 41.5 million dollars. About 60 to 70 per cent of that total will come from the United States.

Total imports from all countries in 1944 (estimated on the basis of Egyptian statistics for the first nine months) amounted to about 200 million dollars. In 1945, the improved supply situation probably will make for larger imports from the sterling area. Even if this expectation is not fulfilled, imports from non-sterling countries will represent only 21 per cent of all imports. In contrast, the non-sterling countries of the Americas and Continental Europe provided about 60 per cent of all pre-war imports.

It is true that Egyptian exports would finance only a fraction of the imports from non-sterling territories which the allocation of dollars from the sterling pool makes possible. In return, however, Egypt had to agree to buy products previously provided by sterling area countries from other sources only if this would mean a saving of more than 10 per cent. This provision gives sterling area exporters a premium of 10 per cent, and makes competition all but impossible in goods traded in the world market at uniform prices. Egypt also had to strengthen its exchange regulations so as to make available to the sterling pool all its earnings in non-sterling currencies. This meant the requisitioning of all non-sterling currencies held by residents of Egypt,[2] and the prohibition of acquiring goods from non-sterling areas beyond the established limit on credit or against payment in domestic currency. This provision removes an incentive to Egyptian merchants to increase exports to the United States for the sake of acquiring dollar balances, and impedes the disposition of U.S. military surplus commodities located in Egypt. If those goods could be sold for local currency, it would be easy to dispose of them, and the proceeds could be used by the local representatives of the United States. As the matter stands, the Egyptian authorities are reluctant to permit the use of their scarce dollar supplies for purchasing surplus goods. This would be of little importance if only the fiscal consequences were to be considered. Actually, however, these goods, especially trucks, could become the vanguard of substantial post-war sales.

For the immediate post-war period, annual imports from the United States have been estimated at about 29 million dollars. Financial payments to the United States may be estimated at about 4 million. If Egyptian exports to the United States, especially of long-staple cotton, again reach the level of the 'twenties, the balance of payments between the two countries would be in equilibrium.

1/ The agreement expresses the figures in Egyptian pounds (1 pound is equal to about 4.15 dollars).

2/ See <u>Review of Foreign Developments</u>, February 19, 1945, page 3.

2. Iraq

Until recently, Iraq occupied a singular position within the sterling bloc: its dollar revenues, mainly from the sale of oil, were credited to a special account and earmarked for Iraqi imports from dollar countries. The British authorities offered Iraq a substantial inducement to do away with this anomaly in the form of a promise to allocate for 1945 the sum of 13 million dollars, which meant about 3 million dollars more than the current balance of the special account plus the estimated dollar receipts in 1945. Apart from the amount of the allotment, the new agreement embodied substantially the same provisions as the one concluded between the United Kingdom and Egypt.

Before the start of the Second World War, American exports to Iraq did not exceed 3 million dollars annually. During the war, military supplies have swelled the total to a multiple of that sum, but post-war exports are estimated at only 3.5 million dollars per year. Iraqi exports to the United States reached 7 million dollars in 1937 and 8 million in 1940. There is no reason to doubt that similar figures could be attained after the war, and Iraq probably will have no need of British allocations for financing its dollar requirements. In 1939, the United States took second place in the country's exports and third (after the United Kingdom and Japan) in its imports. During the war, the neighboring countries of Syria and Iran became the most important customers, and India forged ahead of the United States as a supplier. In 1943, Iraqi imports from all countries amounted to the equivalent of 64 million dollars1/ and its total exports to only 20 million dollars. The small size of exports was due to shipping difficulties caused by the war situation. Iraq has very great natural resources, and their development should give ample opportunities for capital investments, and as a result of the expected rise in national income, for heavy increases in foreign trade.

3. Palestine

American exports to Palestine reached a peak of 7.6 million dollars in 1939, and (after deducting military items) were well maintained at 6.8 million2/ in 1943. Total imports of Palestine, however, increased by 35 per cent between these dates, and thus the proportion of imports from the United States fell from 14 to 7.5 per cent of the total. This decline certainly was due to the war situation. Once supply difficulties are removed, the pre-war proportion probably will be reestablished so that annual American exports of about 11.2 million dollars may be expected even in case Palestine's total imports do not show a further rise. Actually, the national income of Palestine is increasing steadily and therefore a substantial expansion of imports is very likely.

1/ The original figures are in Iraqi dinars (1 dinar is equal to one pound sterling or 4.035 dollars).

2/ The original figures are in Palestine pounds (1 pound is about equal to one pound sterling).

Palestine's exports to the United States were negligible before the war, having reached a peak of only 0.6 million dollars in 1939. But the immigration of Jewish diamond cutters from the Low Countries created an important new industry, which increased exports to the United States to 9.2 million dollars in 1943, and promises a further increase in time of peace.

The picture is marred only by the imposition of extraordinary tariff duties on the sale of some American surplus commodities. In a special instance such a duty amounted to 70 per cent of the dealer's cost, as against a peacetime rate of about 10 per cent. These charges may be justified as war measures tending to prevent the overvaluation of the domestic currency from being used for the profit of traders fortunate enough to get import licenses, like the system adopted by the German authorities for trade between Germany and those German-occupied countries the currencies of which had depreciated in relation to the reichsmark.

Without artificial restrictions, Palestine would be unlikely to experience a "dollar scarcity", even apart from the size of its exports. A constant stream of capital is poured into the country by American Zionists. This stream differs from capital exports to most other countries because a large part of it is presented as a gift, without the expectation of interest or even capital repayment. The American remittances are normally transformed into exports, and it would be almost impossible to hinder this process without endangering the inflow of capital, which is vital to the development of the Palestinian economy. Therefore, it is to be expected that in peacetime the trade between those two countries will not be hampered.

4. Syria and Lebanon

These countries were included in the sterling area until February 1944, and have retained close economic ties with the British-dominated territories in the Near East. Although their currency is officially tied to the French franc, it is actually pegged by an exchange rate guarantee at 8.83-1/3 Syria-Lebanon pounds to the pound sterling.1/ On the other hand, their foreign exchange system is directed by a commission composed of delegates of the central exchange control of the franc bloc and of the Governments of Syria and Lebanon, and is managed by the Bank of Syria and Lebanon. The bank is a subsidiary of the Ottoman Bank, which is controlled by French and British capital, and its currency reserves consist mainly of French francs. Until recently, the French authorities were reluctant to allot dollars to these countries. But according to the latest reports, a sum of 6 million dollars has been provided for 1945. Imports from the United States amounted to about 3 million dollars annually before the war, reached more than twice that sum in later years, and are estimated at about 5 million dollars annually for the post-war period. Total imports from all countries reached 50.3 million dollars in 1943. Exports to the United States amounted to 5 million dollars in 1937, but later fell to about half of that sum, and have not yet increased. Total

1/ Thus the Syria-Lebanon pound is equal to about 0.457 dollar.

exports were only 10.5 million dollars in 1943. At present, the country is therefore dependent on foreign exchange allocations for its import needs. If its exports in post-war years reach the 1937 level, however, its dollar requirements probably would be covered by its own receipts.

5. Saudi Arabia

The war has deeply disturbed the economy of Saudi Arabia by cutting in half its revenues from Mohammedan pilgrimage to the holy cities of Mecca and Medina. Pilgrimage will not resume its former importance even after the end of hostilities in Europe, as long as the Moslems of Southeast Asia, especially Java, are not freed from Japanese rule.

Saudi Arabia being the main source of untapped oil reserves in the Near East, both the United States and the United Kingdom have decided to extend substantial help to the people and the Government of the country. The bulk of all imports are financed by subsidies (United Kingdom) or lend-lease (United States). About two-thirds of the government expenditures, which total about 100 million riyals[1] annually, are covered by these and other grants from the Allied countries; the remainder is met by custom duties, pilgrimage fees, and royalties from the Arabian-American Oil Company, a subsidiary of the Standard Oil and Texas concerns, which allegedly has invested 100 million dollars in the Arab Peninsula. Lend-lease shipments from the United States include gold and silver for currency purposes; these deliveries do not put a real burden upon the United States since the Saudi Government is able to repay the full mint price out of its seignorage profits. These transactions have been made possible by the unification of the country's currency system. Before the war, money in circulation consisted mainly of Indian rupees and Maria-Theresia dollars. The riyal was made sole legal tender in 1943, and it has gradually displaced the other coins. The United States has minted silver riyals, containing 11-2/3 grams of silver 916.6 per mille fine, and small gold bars and discs, which are traded in the market at a price representing 177 to 180 per cent of the official U.S. gold price.

American exports to Saudi Arabia immediately before the war amounted to 4 million dollars annually. In 1944, the figure rose to a multiple of that sum because of the shipments of currency and other lend-lease supplies. But normal peacetime exports probably will not be larger than the amount of dollars available to the country from royalty payments. It is impossible to estimate the exact amount of these payments, but they have already reached the value of the largest American pre-war exports. For a considerable period, additional supplies of equipment for drilling, pipe lines, and refineries will be required. But these items will not influence the Arabian balance of payments since they will be paid by the American oil companies. Post-war trade should therefore encounter no financial obstacles. Since the increasing production of oil and oil products should result in a rise in the standard of living of the population, a sharp increase in foreign commerce may be expected.

1/ The riyal is equal to the Indian rupee (about 0.30 dollars).

Conclusion

Post-war economic relations between the United States and the Near East will be greatly influenced by American foreign trade policy and by the monetary policy of the sterling bloc. If the United States puts obstacles in the way of imports, it might be more profitable for the Near Eastern countries to rely on British allocations of dollar exchange rather than on their own exports. In this case, commerce with the United States certainly would be curtailed in favor of sterling bloc members. If the sterling bloc were used as an instrument of autarky or bilateralism, the results also would be harmful to the United States. This danger would be particularly acute if the sterling creditor countries had to submit to restrictions of their trade with the United States in order to realize their sterling balances. From this point of view, the problem of these balances is of the most immediate interest to the United States. If the sterling area, however, is incorporated into the framework of international monetary arrangements, its existence may prove beneficial to all parties. It would help to prevent the individual countries from pursuing a nationalistic or merely reckless monetary policy by providing them with a uniform currency. Thus it would implement rather than hinder the work of Bretton Woods.