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Rate of Return on United States Foreign Investment, 1919-1940

Randall Hinshaw

What was the net rate of return (or loss) on American foreign investments of the inter-war period? An exact answer to this question is not possible because of our incomplete knowledge of some of the magnitudes involved, but an approximate answer can be worked out without much difficulty. There are at least two methods of dealing with the problem

Method 1. We can express the income received from foreign investment during any given year as a percentage of the total net sum of dollars actually invested abroad. By this method, a rate of return can be worked out on a year-by-year basis by (1) taking as a starting point an estimate of outstanding foreign investment; (2) adding, for each year, new foreign loans, new purchases of outstanding foreign securities, and new net direct foreign investment; (3) subtracting, for each year, amortization receipts and new sales of outstanding foreign securities; and (4) expressing the annual income from foreign investment as a percentage of the figure obtained by performing the first three operations. The rate of return can be computed, not only for foreign investment as a whole, but individually for direct investment and portfolio investment.

The logic of this procedure is that it shows the dollar sums received from abroad in the form of income as a percentage of the net dollar sums outstanding abroad in the form of investment. The method may be viewed as an attempt to get completely away from a market-value approach to the problem. It is not necessary to take separate accounts of defaults in this calculation, since defaults are automatically reflected in lower income and thus in a lower rate of return. It should be pointed out, however, that as long as there is any income at all from foreign investment this procedure always yields a positive rate of return.

In the table on the next page, this method is applied to American foreign investment during the period 1919-40. This table provides a more optimistic picture of the results of that investment than is often envisaged. The rate of return on direct investment for the whole period is in the neighborhood of 6 per cent; for portfolio investment, the rate is approximately 4 per cent; and for foreign investment as a whole, the rate is about 5 per cent.

Method 2. Another (and more conventional) way of estimating the rate of return on foreign investment is to compute the rate of discount which would make the value of the investment at the beginning of the period equal to the sum of (1) the difference between (a) the discounted stream of income throughout the period and (b) the discounted stream of net investment throughout the period, plus (2) the discounted market value of the outstanding investment at the end of the period. While the calculations required for making such an estimate are rather elaborate (involving computation by the procedure of successive approximations), the logic behind the method is quite simple. The method merely attempts to show the average rate of return received by investors during a given period, after allowance is made for any change in the capital value of the investment.

In this procedure, the rate of return can be either positive or negative. When applied to the American inter-war experience, it is found that the rates of return on both portfolio and direct investment are positive, though in the case of portfolio investment the rate is much lower than the rates at which the loans were actually made. For the period 1919-40, the rates of return (to the nearest quarter of a per cent) are as follows: direct investment, 6-1/4 per cent; portfolio investment, 1-3/4 per cent; total foreign investment, 4-1/4 per cent. The latter two figures are lower than the corresponding figures obtained by the first method, since they reflect the sharp decline in the market value of portfolio investments. Yet even these figures provide a considerably brighter picture of American lending experience than is often painted.

Table 1

Rate of Return on American Foreign Investment: Method 1[1]

Year	Outstanding Direct Investment	Dividend Receipts	Rate of Return on Direct Investment	Outstanding Portfolio Investment	Long-term Interest Receipts	Rate of Return on Portfolio Investment	Outstanding Long-term Investment (Total)	Long-term Income	Rate of Return on Long-term Investment
			(Percentage)			(Percentage)			(Percentage)
1919	3,900[2]	433	11.1	2,600[3]	87	3.3	6,500	520	8.0
1920	4,054	452	11.1	3,000	96	3.2	7,054	548	7.8
1921	4,165	208	5.0	3,477	121	3.5	7,642	329	4.3
1922	4,318	351	8.1	4,146	154	3.7	8,464	505	6.0
1923	4,466	457	10.2	4,381	181	4.1	8,847	638	7.2
1924	4,648	347	7.5	5,084	212	4.2	9,732	559	5.7
1925	4,916	454	9.2	5,687	254	4.5	10,603	708	6.7
1926	5,267	446	8.5	6,157	288	4.7	11,424	734	6.4
1927	5,618	429	7.6	6,793	324	4.8	12,411	753	6.1
1928	6,176	474	7.7	7,545	374	5.0	13,721	848	6.2
1929	6,778	467	6.9	7,579	409	5.4	14,357	876	6.1
1930	7,072	373	5.3	7,649	429	5.6	14,721	802	5.4
1931	7,294	180	2.5	7,299	383	5.2	14,593	563	3.9
1932	7,310	85	1.2	7,032	311	4.4	14,342	396	2.8
1933	7,278	105	1.4	7,112	267	3.8	14,390	372	2.6
1934	7,295	200	2.7	6,910	215	3.1	14,205	415	2.9
1935	7,261	320	4.4	6,828	188	2.8	14,089	508	3.6
1936	7,273	380	5.2	6,639	176	2.7	13,912	556	4.0
1937	7,238	410	5.7	6,398	158	2.5	13,636	568	4.2
1938	7,222	440	6.1	6,374	135	2.1	13,596	575	4.2
1939	7,213	400	5.5	6,270	133	2.1	13,483	533	4.0
1940	7,190	450	6.3	6,186	124	2.0	13,376	574	4.3
Average									
1919-40			6.3			3.8			5.1
1920-29			8.2			4.3			6.2
1930-39			4.0			3.4			3.8

1/ Figures derived from Department of Commerce data, unless otherwise indicated.
2/ Estimate by Cleona Lewis. Subsequent figures obtained by adding annual net direct investment (positive or negative).
3/ Estimate by Cleona Lewis. Subsequent figures obtained by adding new foreign loans and new purchases of outstanding foreign securities, and subtracting amortization receipts and new sales of foreign securities.

European Black Market Rates for the Dollar

Hans J. Dernburg

In establishing exchange rates since the end of the war foreign governments have shown a marked tendency to overvalue their currencies against the dollar. This is brought out by calculations based upon the relative development of prices in the various countries.1/ While one may calculate, for example, a hypothetical rate of 87 to 112 Belgian francs per dollar or a rate of 62 to 100 Czechoslovak koruny per dollar, the official rates are 43.83 francs and 50 koruny per dollar, respectively. The same tendency toward overvaluation of foreign currencies against the dollar is evident from a study of European black market rates. Such rates are of doubtful value as indicators of the "true" value of a currency, but they may be useful for revealing certain general weaknesses in the new foreign exchange rate structure which has developed since the war.

When foreign currencies become scarce a country may counteract the situation by introducing foreign exchange restrictions in order to balance its international accounts. Under a system of foreign exchange control, the trade in foreign currencies is concentrated in the central bank or other especially authorized institutions which buy and sell all foreign exchange at officially established rates. All trade in foreign exchange outside of the approved channels and at other than official rates is illegal and subject to severe penalties.

While transactions in bank transfers are easily brought under control, illegal markets often develop for the purchase and sale of imported foreign banknotes at home and of exported domestic banknotes abroad. In the home market, scarce foreign exchange is traded at rates above the official rates, while in the corresponding markets abroad with no, or less stringent, foreign exchange restrictions domestic currency is traded below the rates which would correspond to the officially established parity. In France, for example, the Swiss franc may be traded at rates higher than those established by the Bank of France, while French franc currency may be traded in Switzerland at rates lower than those which the Bank of France has established for the Swiss franc. The rate of discount for the franc may, however, differ considerably between internal and external markets. From the point of view of the country with foreign exchange restrictions (France), the market at home is illegal because transactions take place outside of the central bank and at rates other than those which had been officially established; the market abroad (Switzerland) is also illegal from the point of view of France because it deals in banknotes which have been exported contrary to the law, exchange restrictions prohibiting the export of domestic currency. Only in the former case, where scarce currency is traded in the home market of a weaker currency at other than the officially established rates, is the term "black market" commonly used, but in a broader sense this term should also cover the foreign markets in which the weaker currency is traded at other than the officially proclaimed parity.

1/ See Review of Foreign Developments, May 20, 1946.

Since foreign exchange restrictions tend to maintain an overvalued currency, it is often argued that the less flattering black market rates express more accurately the "true" relative value of a currency. Before the war, it was generally agreed that the official rates established by the German Reichsbank considerably overvalued the mark and it was believed that the clandestine rates for foreign exchange in Germany and the openly quoted rates at which mark notes were exchanged abroad were more representative of the "true" value of the mark. Correspondingly, black market rates have often been cited in present day exchange rate discussions as evidence of the overvaluation of individual currencies.

On the other hand, it is argued that black market rates are entirely unreliable as an indication of the intrinsic value of a currency.1/ In normal times, with no foreign exchange restrictions prevailing, the total volume of transactions in banknotes, largely in connection with tourist traffic, is extremely small as compared with the volume of foreign trade and international financial transactions. Under abnormal, especially inflationary, conditions, such as prevail at present in many European countries, the supply of foreign banknotes tends to increase greatly, yet only a relatively small volume passes from holder to holder. Foreign banknotes, which normally would be shipped back to the country of origin in exchange for bank balances, are hoarded. While under normal conditions foreign banknotes are bought as an international medium of exchange with a view to spending them abroad for <u>foreign</u> goods and services in the near future, under inflationary <u>conditions</u> they are bought as a store of value to be reconverted into <u>domestic</u> currency or domestic goods and services at some rather remote <u>date.</u> Under normal conditions the demand for foreign banknotes as an international medium of exchange is influenced by <u>present</u> relative price levels at prevailing exchange rates. Those, however, who buy foreign banknotes as a store of value under inflationary conditions are speculating on <u>future</u> domestic price changes relative to the <u>development of the exchange rate</u>. As long as domestic prices rise no faster than the exchange value of the foreign currency held, the speculation may bring profits and cannot involve losses. Even should prices of domestic goods increase more rapidly than the price of foreign currency, the speculator will in all probability suffer smaller losses than would be incurred through hoarding of domestic currency. For these reasons black market exchange rates may be expected to run ahead of "true" relative currency values in periods of inflation. One may pay a premium for foreign currency with the expectation either of enjoying profits or of cutting losses.

The premium which speculators will be willing to pay for foreign currencies will be affected also by the risk factors involved. Those engaged more or less habitually in selling foreign exchange illegally will demand some compensation for the ever-present risk of confiscation and more drastic penalties under which they operate. The purchaser, on the other hand, will doubtless reduce his offer somewhat in consequence of the risk which will attach to himself while holding the foreign currency.

1/ See Frank M. Tamagna, "The Fixing of Foreign Exchange Rates," Journal of Political Economy, March 1945, Number 1, page 57.

In evaluating black market rates, it should also be remembered that because of their illegal character black markets are very poorly organized. Traders in these markets are seldom trained bankers; all sorts of individuals--speculators, profiteers, opportunists--who for one reason or another have access to foreign currency flowing from the armed forces, foreign students, tourists, and travelling business men, enter the market. It is therefore not surprising that the rates are susceptible to all sorts of rumors and often show wide fluctuations. It is generally true, moreover, that non-speculative forces frequently distort black market rates. Refugees forced to leave their homeland are willing to accept most unfavorable rates rather than realize nothing on their assets. Certain wealthy individuals and politiciams may be willing to sacrifice large amounts of their own currency to secure assets abroad. Capital flight would, of course, influence free exchange rates in the same direction, but the impact of such currency movements on the restricted volume of black market transactions may be relatively more disturbing.

While for the various reasons stated black market rates provide a poor standard for estimating the correct exchange value of a currency, they may be helpful, if used with circumspection, as evidence of certain general trends. The following table compares black market rates and official rates for the dollar in 13 European countries. Black market rates in all cases are considerably higher than the official rates, a fact which may indicate that all the foreign currencies listed are more or less overvalued with respect to the dollar. In evaluating the individual results, it should be remembered, however, as stressed in the preceding general discussion, that dollars are bought in the black markets mainly as an investment and that black market rates tend to exaggerate the relative cheapness of the domestic currency. While overvaluation is a common feature, its extent is probably considerably less then the table indicates.

European Black Market Rates for the Dollar in April 1946

Country	Monetary unit	Prevailing rate per dollar	Date of establishment	Black market rate per dollar	Black market rate as percentage of official rate
Netherlands	Guilder	2.65	Oct. 1944	5.40	204
Belgium	Franc	43.83	Sept.1944	80.	182
France	Franc	119.107	Dec. 1945	300-315	252-264
Spain	Peseta	11.085	May 1940	25.5 1/	221
Denmark	Krone	4.79	Jan. 1942	10.	208
Finland	Markka	136.	Oct. 1945	400.	296
Poland	Zloty	100.	Dec. 1945	430.	430
Germany	Mark	10.	Sept.1944	300-450	3,000-4,500
Austria	Schilling	10.	May 1945	150.	1,500
Hungary	Pengo	2,516-2,554	Feb.27'46	2,700. 2/	107-105
Czecho-slovakia	Koruna	50.	Nov. 1945	125.	250
Yugoslavia	Dinar	50.	Apr. 1945	150.	300
Greece	Drachma	5,000.	Jan. 1946	5,700-5,900	112-118

1/ Rate quoted in Tangier, Morocco.
2/ Rate as of February 28, 1946.

In the case of eight of the thirteen currencies shown,[1] black market rates for the dollar were two to three times as high as the official rates. In Belgium, the Netherlands, Denmark, and Spain, they are about twice as high, in Czechoslovakia and France about two and one-half times as high, and in Finland and Yugoslavia about three times as high. This is a rather remarkable result since it may imply that these currencies are comparatively little out of balance as related to one another, while overvaluation with respect to the dollar is considerable.

One may seek a common cause for the relatively similar degree of overvaluation relative to the dollar. As a matter of prestige and for other special reasons varying from country to country, there has been a marked tendency in establishing post-war exchange rates to revert to pre-war parities or to give the currencies a comparatively high value relative to the dollar. When rates were established, little could be known about future economic developments and price trends, and since a rate that would accurately fit the future international trade position could not be established, it seemed preferable to establish a valuation that might prove too high rather than too low. A future correction by devaluation would cause less friction than an upward revaluation.

Another aspect of the situation deserves mention. Instead of saying that these currencies are overvalued relative to the dollar, one may with equal validity say that the dollar is undervalued relative to the European currencies. Analysis of the black market rates for dollar and pound sterling notes in various European markets shows that in relation to each other the pound sterling note has been selling in those markets at a discount or the dollar note at a premium. The following table shows that on the basis of cross-rates derived from black market quotations the pound has been traded for several years below the official ratio of about four dollars.

Date	Market	Cross-rate (Dollars to the pound)
June 11, 1943	Zürich	2.94
Oct. 21, 1943	"	2.98
Dec. 20, 1943	"	2.89
March 8, 1944	"	2.94
June 30, 1944	"	3.31
July 1944	Istanbul	3.50
November 1944	Paris	2.10
January 1945	"	2.73
March 1945	Istanbul	3.04
Apr. 14-30 1945	Budapest	1.95-2.22
May 2-7, 1945	"	2.30-2.47
July 6, 1945	Istanbul	1.84-2.96
March 20, 1946	"	1.82-2.58
March 25, 1946	Warsaw	2.27
Apr. 17, 1946	Tangier	2.70-2.76

1/ Conditions in the remaining five countries (Austria, Germany, Poland, Greece, and Hungary) are extremely unsettled both for political and economic reasons. The small spread between the black market rate and the official rate in Greece may be explained by the fact that Greece had just devalued its currency. The same phenomenon in Hungary is due to the fact that official exchange rates are established daily, based on index numbers of prices.

These rates show great deviations from the official dollar-pound rate, in some cases up to 50 per cent, and it has been suggested that they indicate certain weaknesses of the pound sterling as compared with the dollar. In the various markets the spread between official rates and black market rates is relatively greater for the dollar than for the pound. With respect to sterling, therefore, the European currencies appear to be less overvalued than with respect to the dollar. Another way of expressing this is to say that the dollar is undervalued with respect to all European currencies including the pound sterling.

Relaxation of Foreign Exchange Control in Italy J.H.F.

Italy has become the first European ex-belligerent to legalize a free market in foreign exchange. Until recently, exporters had to deliver all foreign exchange proceeds to the Government at rates which corresponded to the "premium price" of 225 lire per dollar. Under the decree-law of March 26, and the decree of April 13, 1946, exporters must now deliver only one-half of their foreign exchange proceeds to the Government at the stated rates and may retain the other half. They are under obligation, however, to use the free half within 90 days after acquisition, either in payment for specified imports, or for transfer through accredited banks to another importer. These transfers will take place at free market rates to be calculated by the members of the stock exchanges (banks, bankers, and brokers) in proceedings similar to those by which quotations are set for securities. It is expected that these free market rates will be in the neighborhood of the former black market quotations of 300-325 lire per dollar.

The decision of the Italian Government to permit such a foreign exchange market is particularly interesting in view of the Italian application for membership in the World Fund and Bank. Black market prices for foreign exchange in Italy have shown remarkable stability, and it is to be expected that the free market rates will fluctuate even less widely. The Government probably will adopt the free market price as the official dollar rate of the lira, to be communicated to the World Fund after Italy's admission. Institution of the free market would thus be a way of arranging for devaluation of the lira to a level which represents an actual market equilibrium. A rate of around 300 lire per dollar would represent a depreciation to approximately one-fifteenth of the pre-war figure, and would correspond to the increase in the price level (taking into consideration black-market transactions). It would permit the Government to stabilize prices at the present figure without inflationary or deflationary consequences, and to raise wages, which so far have been kept at a fraction of the increased price level. If this interpretation of the Government's action is correct, and if the actual outcome conforms to expectations, the readmission of free foreign exchange transactions could be an important step toward normalizing Italy's monetary situation.

British Bulk Buying

Wilellyn Morelle

Bulk buying in various forms has long been a minor feature of the commercial policies of most countries. In Britain bulk buying contracts have been entered into by associations of users and by single firms which were the sole importers of certain materials. The British Government in directing the imports of foods from a number of countries in pre-war years also approached the bulk contract method of trading. These activities were not associated in the public mind with the concept of state trading, however, until the British Government became the sole buyer and seller of most imported foods and raw materials during the war.

As a purchaser for the Combined Boards and as a supplier of the United Kingdom's needs, the Government took over the functions of the regular markets, although in most instances experienced private traders were employed as agents of the Government or as members of the civil service. With resources more extensive than those of private traders, the Government was able to adjust its operations to disruptions in normal channels of trade and to secure the entire output of certain producers or producing areas. In critical periods, government purchasing contributed to a continuous supply of strategic materials. For the most part, contracts were made at prices near the pre-war level adjusted for increased production costs and thereby facilitated the enforcement of domestic price control by insulating the economy against uncontrolled inflationary price increases for imports. Too, the centralization of buying and selling simplified administration of the domestic rationing system and of the huge subsidy program for domestic agriculture.

The success of the state trading program as a war measure probably played a part in influencing the Labor Government to carry over certain of its features into the peace-time economy. A number of war-time contracts for purchases of food extended into the post-war period. Other contracts providing for large imports, primarily of food but to a lesser degree of raw materials, have been entered into by the State since the end of hostilities. A policy of official secrecy concerning commodity stocks on hand and a general reluctance to publish details of existing or prospective bulk contracts make it virtually impossible to estimate the extent of the United Kingdom's state trading activities. In fact, such information is often more readily available from the supplying countries than from the United Kingdom.

Occasional notices in the press give meagre accounts of contracts concluded for large quantities of foodstuffs. In August 1945, the London Times carried a story by its Buenos Aires correspondent announcing conclusion of an agreement between Britain and Argentina under which Argentina will export to Britain and others of the United Nations in the next four years meat valued at 150 to 200 million pounds. Details of prices and quantities were not revealed. On November 8, 1945, the same paper carried an account by its Wellington correspondent of a four-year contract concluded between New Zealand and Britain whereby the United Kingdom agreed to take all the available beef, veal, mutton, lamb, and their edible offals until September 30, 1948, and all available pig meats until September 30, 1946. Prices were fixed for the first two years at those of the 1939-40 contract plus one-third, with the right to renegotiate granted to either Government at the end of the two-year period. In January 1946, notice of an agreement by the British Ministry of Food to take Australia's exportable surplus of pig meats to September 30, 1947 (instead of the 30,000 tons previously agreed to) was carried in the Sydney Morning Herald. Also in January Canadian press releases stated that virtually all of the Canadian-United Kingdom food contracts would be renewed or extended although negotiation of details had not been completed. Repeated allusions to a four-year wheat contract between Britain and Canada would seem to indicate that such a contract is or has been under discussion.

For the duration of the world food shortage, the quantities and sources of supplies of food allocated to the United Kingdom will be determined largely by the Combined Food Board. Under these conditions of short supply, the Ministry of Food will be inclined to enter into contracts for staple commodities wherever exportable supplies are to be found. As world supplies increase and alternative sources of supply become available, many other factors will undoubtedly influence the direction and extent of bulk purchases. Preliminary plans for a heavily subsidized domestic agriculture were announced by the Labor Government in November 1945, and can be expected to affect the pattern of British food imports. The British exchange position will play a still more important part. Present indications point to a continuation of the Ministry of Food as a permanent agency with full control over the United Kingdom's food supplies. In this event, that agency will be charged with sole responsibility for weighing these factors and arriving at decisions concerning the procurement of food from domestic and foreign sources to the greatest advantage of the British people.

Since the Labor Government took office with its hearty endorsement of the principle of bulk purchasing, concern for the future of the organized commodity markets has been very widely expressed. A year earlier the British Federation of Commodity and Allied Trade Associations launched a vigorous protest against the projected continuation of Government bulk buying as a permanent feature of British trade policy. Objections expressed by the Federation at that time represent more or less the current views appearing in the conservative press:

(a) The rising market on which bulk purchases were made during the war assured price advantages on any long-term contract. Peace-time fluctuations in price place the Government in the position of speculating with the peoples' money when contracting for long-term bulk purchases.

(b) Cooperation between consuming countries and between consuming and producing countries will end with termination of the Combined Board arrangements whereby competitive bidding between the Allies has been avoided. British bulk buying can be expected to stimulate retaliatory bulk buying by other countries.

(c) Absence of commodity markets will almost certainly result in payment of relatively high prices by the British. The Government may be able to buy at a low cost by taking all of certain producers' output. Other producers, however, will have to find their own markets and will ultimately sell at less than the United Kingdom contract price.

(d) Failure to reopen commodity markets will entail a considerable loss in invisible imports--foreign exchange earned through commissions, banking, insurance, and shipping services--a loss the United Kingdom can ill afford.

Unmoved by the opposition of the Liberals and Conservatives, the Labor Government on March 18, 1946, announced its decision to continue centralized purchasing of raw cotton through a permanent cotton purchasing commission yet to be established. Sir Stafford Cripps in announcing the Government's decision in the House of Commons made the following assertions:

"(a) Centralized purchases of raw cotton will enable supplies of cotton to be obtained at least as economically as by private importation and with greater certainty and regularity.

(b) Bulk purchases will facilitate the maintenance of reasonable stability of price to the spinner, and will facilitate price stabilization of utility cloth, which is an important element in the cost-of-living policy.

(c) It is unlikely that post-war international conditions will in any event favor the operation of a cotton futures market of pre-war type.

(d) Undesirable speculation on the cotton futures market engaged in by those outside the industry itself will be eliminated.

(e) Bulk purchases provide the Government with a powerful instrument in making reciprocal trade and exchange arrangements and for influencing the course of international commerce in the direction required for equilibrium."

Sir Stafford Cripps' third point deserves attention. One conclusion to be drawn from this statement is that the Labor Government does not envision a world cotton situation with supply and demand equilibrated by price. But rather, in view of the present world glut of raw cotton, the Labor Government foresees a situation in which the major part of the world supply will be supported by Government operations. The action taken by the United States and Brazil in supporting cotton prices probably justifies this view.

In announcing that the Liverpool Cotton Exchange would not be reopened, the Government took occasion to emphasize that the decision on cotton did not imply a general principle. It was also pointed out repeatedly by the Government in the ensuing Parliamentary debate that the question of centralized purchasing of raw materials must be considered case by case in the light of facts rather than of theories.

Lord Keynes, in his discussion of the terms of the Anglo-American loan agreement before the House of Lords, expressed the opinion that state trading and bulk purchasing are within the limitations of the British obligations under the agreed proposals for expansion of world trade. The United States has taken the position that bulk trading by governments is contrary to liberal trade practices and should not be continued beyond the emergency period. The British at the time of the loan negotiations explained in some detail the terms and practices contemplated and the United States withdrew its objection, perhaps temporarily. For the fact remains that the bulk purchasing method of trading does not provide an environment particularly favorable to the development of the free trading practices provided for in the proposed world trade charter. Instead, it provides an environment peculiarly suited to the growth of bilateralism and "economic blocism."

Agreement Concerning German Assets in Switzerland

Rosa Ernst

When in March 1945 the mission headed by Lauchlin Currie returned from Switzerland, it reported complete success in its negotiations with that country and stated that the following objectives, among others, had been accomplished:

(1) All German assets in Switzerland, including those held by Swiss nationals, had been frozen;

(2) Measures had been adopted to stop all exporting and importing of and dealing in foreign currencies;

(3) The Swiss National Bank had agreed not to purchase any further gold from Germany;

(4) The Swiss Government had given broad commitments to facilitate the restitution of looted property to its rightful owners;

(5) Coal shipments to Northern Italy through Switzerland had been suppressed, thus hampering German military action as well as the operations of German industry in the north of Italy. (As a matter of fact, these coal shipments had been stopped fully a month before the negotiations were concluded.)

In return for these and other concessions, the Swiss were to receive from the Allies agreed quantities of foodstuffs and certain industrial raw materials.

The Swiss authorities at once took steps to carry out the provisions of this agreement. After blocking all German assets under regulations issued in February and April 1945, the Federal Council in May enacted special legislation according to which any German assets held on February 17, 1945, had to be declared. The Swiss Clearing

Office (set up in 1934) was empowered to conduct the investigation of German-owned assets. Much opposition was encountered in banking and legal circles which held that the traditional banking and professional secrecy should not be violated, and which did not hesitate to express their resentment at so-called unwarranted Government interference in their private affairs. On the other hand, Swiss private interests, anxious to make use of their frozen assets in the United States (reported to amount to about 1.5 billion dollars) and to be removed from the so-called "black list" of the Allies, brought pressure on the Swiss authorities for greater speed in the conduct of the investigation. The Swiss press and public opinion in general supported a thorough and fair determination of the facts with no special favors to either side. Despite all opposition, the Swiss Clearing Office was authorized to open bank safes and safe-deposit boxes in an effort to arrive at accurate figures. Finally, in November, a statement was published giving preliminary figures on German holdings.1/ This data revealed German assets amounting to about one billion francs (about 234 million dollars at the official rate of exchange) while American estimates have placed those assets around 750 million dollars. The Swiss pointed out, moreover, that almost an exact equivalent of one billion francs was due them from Germany in settlement of Swiss-German clearing deficits.

In the meantime, the Allied press carried dispatches charging that the Swiss were using dilatory tactics in their investigation and that they were assisting Germany to lay the foundations for another world war. It also published reports of huge amounts of German holdings concealed in Switzerland (in one instance as much as 16 billion francs was mentioned). These unsubstantiated estimates were greatly resented by financial circles as well as by the Swiss public in general. In return, the Swiss Government invited the Allied authorities to visit the Swiss Clearing Office to satisfy themselves that everything was being done to locate the German holdings speedily and accurately.

In March of this year, negotiations were begun in Washington in an effort to bring the controversy to a satisfactory conclusion. The negotiators for the Allies were Mr. Randolph Paul for the United States, Mr. F. W. McCombe for the British, and Mr. Paul Chargueraud for the French Governments, respectively, while Mr. Walter Stucki represented the Swiss Confederation. The Allies based their claims to the German assets on a clause in the Potsdam agreement which reads as follows: "18. Appropriate steps shall be taken by the Control Council to exercise control and the power of disposition over Government-owned external assets not already under the control of United Nations which have taken part in the war against Germany." The Swiss countered by saying that the Potsdam agreement was incompatible with Swiss jurisdiction and that it had therefore no validity on Swiss soil. They also refused to acknowledge a decree-law issued by the Allied Control Council on October 30, 1945, concerning the surrender of all German assets on the basis that such a decree issued by foreign military commanders in a foreign country had no legal validity in Switzerland.

1/ See Review of Foreign Developments, January 14, 1946, p. 4.

On the other hand, the Swiss authorities suggested that the controversy be submitted to international arbitration, a proposal which the Allies found unsatisfactory. Several times the negotiations had to be interrupted to allow Mr. Stucki to return to Switzerland to confer with his Government regarding further steps to be taken. Although the Swiss authorities were well aware that the release of the blocked Swiss assets in this country depended on successful conclusion of these negotiations, they gave the impression that they would prefer for these assets to remain frozen rather than deviate from their interpretation of Swiss law. The negotiations dragged on for over two months during which time proposals and counterproposals were made and rejected.

In a separate issue, the question of gold looted by the Germans and concealed in Switzerland was also considered. An Allied estimate of this gold was as high as 200 million dollars; the Swiss claimed that any such gold was bought by them from the Germans in good faith and through normal transactions.

Finally, on May 26, an agreement was signed according to which the Swiss will turn over to the Allies 50 per cent of the German assets held in Switzerland. A final valuation of these assets is not yet available, but will be determined by a further census to be made by the Swiss Clearing Office aided by an Allied Commission. The United States and Great Britain will each receive 28 per cent of the Allies' share of these assets, while France will get 16 per cent, and other European countries will share in the remainder. In addition, the Swiss will turn over to the Allies approximately 58 million dollars worth of the gold acquired from Germany. The United States and Great Britain will make no claim to this gold, which will be divided among France, Belgium, and other countries from which the Germans seized gold during the war.

The agreement must be ratified by the Swiss Parliament. A bitter fight is expected in both houses, although ultimate ratification may be anticipated.

The accord with Switzerland will doubtless serve as a model in future negotiations with other neutral countries, such as Sweden, Spain, and Portugal concerning surrender of German assets in those countries.

Poland Establishes Official Exchange Rate — Hans J. Dernburg

The recent establishment of an official exchange rate of 100 zlotys to the dollar is of limited practical significance at the present time. Poland's foreign trade has become a state monopoly which means that the formal rate of exchange need not influence the volume of the nation's trade in view of the ease with which prices of imported and exported goods may be manipulated in terms of the domestic currency. At the present time, moreover, most of Poland's trade is being conducted on the basis of barter arrangements; no external exchange rate is involved in these agreements and valuations are generally expressed in terms of currencies other than the zloty.[1] Practical application of the rate may be limited to such transactions as emigrant and charitable remittances, expenditures of diplomatic representatives, and expenditures of travelers. Even in these fields its application will be greatly handicapped as long as there exist in Poland black markets for foreign banknotes at which foreign currency is bought at rates much higher than the official rate.

From 1934 until the outbreak of the war, the zloty-dollar rate averaged 5.30 zlotys to the dollar. The same rate (5.30 rubles to the dollar) has been quoted for the ruble by the Russian State Bank since July 17, 1937. As a result, the Polish zloty and the Russian ruble were at par before the Second World War, both being worth about 18.9 cents. The parity between the zloty and the ruble continued as the basis for financial transactions in the liberation and early post-liberation period. Russian ruble currency was introduced at par with the zloty and was again withdrawn from circulation at that rate. German mark currency was exchanged for zloty currency at the rate of 2 reichsmark = 1 zloty, at which ratio the Russians introduced Allied military mark currency in Germany.

Since no new rate was officially established following liberation, press reports continued to consider a rate of some 5 zlotys to the dollar as the "official" or "legal" rate. Such terminology, however, was incorrect. In an interim period lasting until April 1946, Poland appears to have had no official exchange rate covering all commercial and financial transactions. This is confirmed by a statement of the Polish Finance Minister in August 1945 in which he disclaimed any intention of establishing general foreign exchange rates for the zloty.

The new rate of 100 zlotys to the dollar was introduced gradually. A press report of October 10, 1945, mentioned "the new special rate on foreign transactions of 100 zlotys to the dollar," and in early December 1945, Warsaw stated that the Polish Foreign Exchange Commission had established a rate of 100 zlotys to the dollar for remittances from abroad by individuals and of 110 zlotys to the dollar for remittances by charitable institutions. On December 28, 1945, the Polish Foreign Exchange Commission established the following diplomatic rates which were the aggregate of the pre-war rates and an equalization premium:

1/ See Review of Foreign Developments, January 28, 1946, p. 5.

	Rate	Equalization premium (In zlotys)	Total
United States dollar	5.30	94.70	100
United Kingdom pound sterling	21.36	381.64	403
100 Swedish Kronor	126.19	2,252.81	2,379
100 Swiss francs	123.60	2,201.40	2,325

The general official rate was not established until April 20 of this year when, according to press reports, the Polish Foreign Ministry informed all diplomatic missions that the official exchange rate had been established at 100 zlotys to the dollar and 403 zlotys to the pound. It appears that on this occasion the equalization premium was absorbed into a new single rate.

In the discussions which preceded establishment of the official rate, Warsaw diplomatic circles had expressed the opinion that a rate of 100 zlotys to the dollar would greatly overvalue the zloty and that a rate of 250 or 300 zlotys to the dollar would be more appropriate. Warsaw black market rates for dollar notes had been considerably higher than the selected rate, but the former are undoubtedly inflated by unusual demands for dollars for purposes of safe investment and capital flight. Between October 1945 and March 1946 dollar currency sold in the Warsaw open market at rates ranging from a low of 270 zlotys per dollar on October 5, 1945, to a high of 600 zlotys per dollar on January 10, 1946. In March the rates ranged from 420 to 470 zlotys per dollar. Rates in provincial centers were even higher than the Warsaw rates.

As a member of the International Monetary Fund, Poland will be required to communicate to that institution the zloty exchange rate prevailing on October 27, 1945. Since on that date Poland appears to have had no official exchange rate, it is anyone's guess what rate Poland will communicate as the "prevailing rate." The rate finally chosen as the par value of the zloty for operations of the Fund will have to be agreed upon between Poland and the Fund, but it is possible that Poland will suggest the new rate as the par value of the zloty. As has already been suggested, this rate is by no means uncontroversial. It has been rumored, for example, that the United Kingdom does not expect to recognize the new rate which Poland established unilaterally.