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## Report on Mexico City Conference of Central Bank Experts

David L. Grove

For the past few years, there has been considerable informal discussion among the central banks of the Western Hemisphere concerning the desirability of holding a conference at which technical experts of these institutions would meet to exchange informal views about the monetary and banking problems of their respective countries and of the Hemisphere as a whole. The outcome of these discussions was that the Bank of Mexico convoked a conference, which was held in Mexico City between August 15 and 30. With the exception of Honduras, Panama, Cuba, and Haiti, all of the 21 republics of the Western Hemisphere were represented. The absence of Cuba was due to the fact that it does not yet have a central bank or its equivalent.[1/]

With the exception of a decision to establish a Permanent Committee, the conference passed no resolutions and arrived at no official conclusions. The conference was called for the purpose of providing an opportunity for informal discussions which would in no way commit or embarrass the organizations which the delegates represented. It was attended by no publicity. It was the feeling of apparently all of the delegates that they profited from this interchange of ideas and that the associations established would pave the way for greater cooperation among the participating central banks than has existed heretofore.

1/ The United States delegation consisted of Mr. Woodlief Thomas and Mr. David Grove of the Federal Reserve Board, Mr. Horace Sanford and Mr. Henry Wallich of the Federal Reserve Bank of New York, and Mr. Watrous Irons of the Federal Reserve Bank of Dallas. The International Monetary Fund was represented by Mr. Robert Triffin and Filipe Pazos.

The program of the conference was organized around the deliberations of three committees:

I. A Committee on Monetary and Credit Controls.
II. A Committee on Balance of Payments and Foreign Exchange Problems.
III. A Committee on Cooperation among Research Departments of Central Banks.

This third committee, in turn, was split into six subcommittees:

A. Functions of Economic Research Departments.
B. Monetary and Banking Statistics.
C. National Income.
D. Balance of Payments.
E. Other Statistics.
F. Interchange of Statistics and Personnel.

The delegates participated in the committees or subcommittees which were of interest to them, and meetings were scheduled in such a way as to present as little conflict as possible.

Too much space would be required to review all of the discussions which took place and the documents which were presented during the course of the Conference. Accordingly, an endeavor will be made to cover only some of the highlights.

Committee I, the Chairman and Vice-Chairman of which were Mr. Thomas of the Federal Reserve Board and Mr. Triffin of the Monetary Fund, respectively, first reviewed recent monetary and banking developments in the various countries. Emphasis in nearly all cases was placed on the development of inflationary forces. There was a general opinion among the Latin Americans that the inflation in their countries is the result of the highly favorable balances of payments which they have experienced during the war, and that rather little can successfully be done to counteract inflation until imports from the United States become available in larger amounts. It was pointed out by Mr. Thomas that while our exports help combat inflation in the recipient countries, they have the contrary effect here at home, and for this reason the United States has found it necessary to place certain restrictions on exports, and will have to continue to do so.

The theory that the economies of the Latin American countries move more or less automatically in response to developments in the United States appeared to be shared by all of the Latin American delegates, but was most eloquently expounded by Dr. Prebisch, formerly manager of the Central Bank of Argentina. He distinguished between "central" and "peripheral" countries. An exact definition of a "central" country was not made; however, certain characteristics of central countries were indicated. First of all, a central country must be one which plays a large role in world trade. Secondly, it must be one which, in times of depression, can produce a large and rapid capital inflow, either through repatriation of its own capital investments abroad or through attraction of foreign capital. There was the implication that there can be only one central country at a time, with other countries being either quasi-central or peripheral. Until recently, England was the central country, but its position has now been taken by the United States.

Dr. Prebisch's thesis is that the control of booms and depressions rests with the central and quasi-central countries, and that the peripheral countries can do relatively little to combat cyclical movements, although he admitted that unsound domestic policies of the peripheral countries could aggravate the situation. Mr. Triffin pointed out that depressions are not always transmitted from the central countries, as witness the depression in some of the agricultural countries in the late 'twenties, when income in the central countries was still high. Those depressions were caused by overproduction in the agricultural countries and not by a decline in the demand of the central countries.

After the rather rapid review of recent developments in each of the countries, there followed a lengthy discussion of recent central bank policies and of the instruments of control adopted to carry out those policies. Opinions were exchanged with respect to the use of rediscounts and advances, open-market operations, flexible reserve requirements, selective credit controls, capital requirements, and interest rates as instruments of control, and the experiences of the various countries with these instruments were described. The Latin Americans were unanimous in expressing the view that the traditional instruments of control cannot always be adapted to the conditions prevailing in their countries and that where an attempt has been made to do so, their use has been ineffective. The lack of a government securities market limits the use of open-market operations, considered one of the most potent monetary weapons here in the United States. Changes in reserve requirements are relatively ineffective because the favorable balances of payments during the war period have increased bank reserves tremendously. In many of the countries, the increase in the money supply has been largely due to the acquisition of international reserves, and not to an expansion of bank credit. In these cases, increases in reserve requirements would have little effect. As a case in point, the Mexican delegates remarked that, for banks located in the Federal District of Mexico, reserve requirements against demand deposits were raised to a level of 50 per cent, but the inflow of foreign exchange constantly created new bank reserves and made possible further credit expansion. On May 22, 1944, the Bank of Mexico placed a ceiling on the loan and corporate security holdings of all banks, based, in each case, on the amounts of such assets held on May 17, 1944. The ceiling has proved to be effective in restricting the total volume of bank credit, but has presented many administrative problems. Furthermore, the method is not selective, and one of the results has been to produce a shift in the composition of bank assets; relatively more funds are going into types of loans which the Bank of Mexico wishes to discourage but on which the banks obtain a higher rate of return, and relatively less funds are available for operations such as production loans, which the Bank of Mexico wishes to encourage.

The prevailing rates of interest on bank loans are very high in Latin America. Mr. Villasenor, Director General of the Bank of Mexico, declared that the experience of the central banks has been that efforts to bring interest rates down are usually unsuccessful, and that in cases where they are successful, there is often an outflow of capital which makes the continuation of the effort impossible or at least unadvisable.

A great deal of attention was given to a discussion by Mr. Thomas of the measures of selective credit controls on security loans and consumer credit which have been adopted by the United States and to his evaluation of the problems involved in applying such controls. The Latin American countries have adopted very few such controls, but some of them, notably Mexico, felt that if inflationary forces continue to mount, then similar measures may, in some cases, have to be adopted in their countries.

Committee II, which was designated to study balance of payments and foreign exchange problems, was presided over by Dr. Hermann Max, Chief of the Research Department of the Central Bank of Chile.

Balance of payments and foreign exchange problems are the central problems of most of the Latin American countries. To a considerable extent, their economic acitivities are governed by changes in foreign demand for their exports, and they have little control over this demand. Exchange controls have thus come to assume a greater importance than domestic controls. Furthermore, domestic policies are often limited or counteracted by changes in the balance of payments.

Mr. Urquidi, of the Bank of Mexico, presented a paper entitled "Analysis and Characterization of Various Types of International Disequilibrium," in which he endeavored to classify disequilibria according to their origin, intensity, duration, and other characteristics. The problem of defining a "fundamental disequilibrium" was of special interest to all the delegates because of the importance of this concept in the Articles of Agreement of the International Monetary Fund.

Dr. Prebisch stated that fundamental disequilibrium should be defined in terms of cost-price relationships. A fundamental disequilibrium can come about in two ways: (1) if domestic costs of export goods rise and prices fail to follow, and (2) if export prices fall and costs fail to follow.

Mr. Triffin expressed the view that the definition of a fundamental disequilibrium cannot be made entirely dependent upon cost-price relationships. He then offered the following definition:

> "A fundamental disequilibrium is a maladjustment in a country's economy so grave and persistent that the reestablishment or maintenance of a satisfactory level of employment, prices, economic activity, and national income would require extraordinary measures to defend the equilibrium of the balance of payments of the country, such as a change in the exchange rate, the establishment of a permanent system of exchange control, a thorough revision of the tariff system, etc."

Both Mr. Triffin and Dr. Prebisch appeared to agree that, insofar as a disequilibrium of the balance of payments is concerned, exchange control is likely to be more effective, if properly established and administered, than is devaluation, at least for Latin American countries. The chief effect of devaluation in Latin America has been to raise domestic income and employment; in most cases any beneficial effects on the balance of payments have been negligible in the short run and their existence in the long run has been questionable. Dr. Max did not agree with this conclusion, however, and appeared to place much more faith in the efficacy of devaluation in remedying an unfavorable balance of payments.

Mr. Triffin explained that not all disequilibria in the balance of payments are fundamental, and, consequently, not all disequilibria require corrective action. Furthermore, not all fundamental disequilibria manifest themselves in a disequilibrium in the balance of payments. It is most important to distinguish between the disequilibrium itself (or its causes) and its concrete manifestation in any given case. In accordance with the theory of general equilibrium, any disturbance in the economy of a country has repercussions and manifestations in various sectors. Thus, a disequilibrium which originates in external problems of international economic equilibrium may manifest itself not in a disequilibrium of the balance of payments, but in one which appears to be purely domestic, such as, for example, grave unemployment.

Once an agreement has been reached that a given disequilibrium is a fundamental one, it does not follow that a modification of the parity of the currency would constitute the only, or even the best, way of remedying the situation. He stated that the following points must be considered:

(1) What practical alternatives are at the disposition of the country or of the international community to remedy said disequilibrium? For example, exchange control might be advisable in the case of one country and inadvisable in the case of another.

(2) What will be the international repercussions of a change in parity?

Mr. Triffin said that he believes that other countries should not have the right to object to a modification of the parity of one country simply because the modification would result in a reduction in their own exports or in an increase in their imports. In many cases, a country which finds itself in a position of fundamental disequilibrium cannot remedy the situation except by increasing its exports and reducing its imports. The fact that a modification of the parity effectively leads to such a result should not be an objection against the adoption of this measure. As a general thesis it might be said that these consequences of a modification of parity should not be used as an objection in instances where the increase in exports and the decrease in imports simply result in the correction of the disequilibrium and not in an excessive accumulation of gold and foreign exchange. The effects on other countries should be carefully considered, of course, and in each case the problem should be examined to see if other measures might not be preferable, and if other measures should be adopted simultaneously.

The delegates attending the meetings of Committee II were very much interested in a discussion of the system of exchange control which Mr. Triffin has introduced in the legislation of Paraguay and Guatemala. Dr. Prebisch then related the experiences of the Central Bank of Argentina with a similar system, and explained why, in his opinion, exchange control must at times be adopted by the Latin American countries so long as the central countries continue to be subject to intense cyclical fluctuations.

Committee III, which was entitled "Cooperation among the Economic Research Departments," as has already been indicated, established six subcommittees, each of which studied one of the following problems: (1) functions of economic research departments, (2) monetary and banking statistics, (3) calculation of national income, (4) balance of payments statistics, (5) other statistical data, and (6) interchange of information and personnel.

The Subcommittee studying monetary and banking statistics suggested;

> (1) that all the central banks adopt uniform and comparable definitions and forms for the presentation of monetary and banking statistics;
>
> (2) that the uniform data mentioned above be interchanged by all the central banks of the Western Hemisphere with one another.

The subcommittee proposed adoption of uniform central bank and commercial bank balance sheet forms which Mr. Triffin had submitted. These balance sheets, together with the total monetary issue of the Treasury, would supply all the data necessary for monetary analysis.

Two statistical methods of monetary analysis were presented, one by Mr. Triffin and another by Dr. Prebisch and Mr. Pratt, who is Chief of the Monetary and Banking Statistics Section of the Research Department of the Bank of Mexico. The basic difference between the two systems was that Mr. Triffin excluded Treasury deposits from the money supply whereas Dr. Prebisch and Mr. Pratt included them. The subcommittee decided that the central banks should experiment with both systems in order to see which one proves to be the more useful in practice.

The subcommittee studying national income suggested:

> (1) that central banks promote or themselves undertake estimations of National Income, Net National Product, Gross National Product, Consumption, Savings, and Investment;

(2) that this work be initiated by estimating national income, using the payments approach, and then later, in order to check the results, that estimates be made of Gross and Net National Product using the Use-of-Product approach, and

(3) that every effort be made to see to it that the 1950 census includes all the elements necessary for the above-mentioned estimates.

The subcommittee studying balance of payments statistics recommended:

(1) that an effort be made to present balance of payments data in a comparable form;

(2) that the values be expressed both in national currency and in United States dollars;

(3) that estimates be made of the expected demand for and supply of foreign exchange for the use of the monetary authorities;

(4) that all international transactions be computed in order that the balance of payments register not only movements of foreign exchange or financial movements, but all transfers of economic values;

(5) that new domestic gold production, excluding domestic industrial consumption, be included among current transactions. The reason for this is that, since gold is considered as a liquid international asset, the purchases of domestic gold production by the central bank should be considered as a source of supply of international means of payment; and

(6) that the studies of balances of payments not be limited to a simple presentation of data, but that the procedures followed be explained and that an analysis be made of the effects of the various components of the balance of payments on other economic factors such as national income, money supply, price levels, etc.

The subcommittee studying other statistical data discussed the necessity of preparing adequate price, production, cost of living, and other statistical series and some of the technical problems involved in so doing.

The subcommittee charged with the discussion of interchanging information and personnel made one of the most important contributions of the Conference. It suggested the establishment of a Permanent Committee of Central Bank Experts of the American Continent whose principal functions would be the following:

(1) To coordinate and promote interchange of

(a) information about legislative and regulatory measures;
(b) economic and statistical studies of a non-confidential character; and
(c) bibliographical information;

all this to the extent that it affects or refers directly or indirectly to central banks.

(2) To facilitate and promote the interchange and training of technical personnel of the central banks in every way that may be considered adequate.

(3) To formulate a provisional agenda for a second conference of experts on central banking problems of the American Continent.

(4) To contribute, through the preceding functions, to the intensifying and broadening of studies on central banking in the American Continent and to propose the best form of permanently systematizing said studies.

It was proposed that this permanent committee consist of six members, each appointed for a period of two years, who would, at the present time, represent the central banks of Chile and Argentina for South America; Colombia and Costa Rica for the Carribean and Central American area; and Mexico and the United States for North America. The committee would function through a permanent secretariat located in Mexico but would not require the presence of its members in that country. If any central bank does not accept its nomination as a member of the permanent committee or withdraws from said committee, the other members would designate another central bank to take its place. The permanent committee would begin functioning in a provisional manner upon the conclusion of the present conference and would assume a definitive character once the central banks on the committee have accepted their appointment.

Committee III approved the recommendation of its subcommittee and a resolution based thereon was approved by a plenary session of the Conference.

The Permanent Committee should provide a most useful means of giving continuity and permanence to the interchange of information and ideas which was so successfully initiated at the Mexico City Conference.

The representatives of the Central Bank of Chile requested that the second conference, which will be held about two years from now, take place in Chile.

Bulk Sale of Surplus to China John Exter

On August 31 in Shanghai Dr. T. V. Soong, President of the Executive Yuan, and Mr. Thomas B. McCabe, United States Foreign Liquidation Commissioner and Special Assistant to the Secretary of State, announced an agreement for the bulk sale to China of all United States civilian-type surplus located in China and in the Western Pacific outside of the Philippine Islands. (It is believed that all surplus located in the Philippines will be sold to the Philippine Government if agreement on terms can be reached.) As principal payment, China agreed to cancel the American indebtedness to her arising from all advances of Chinese National dollars (CN$) to the United States during the period January 1, 1945, to August 31, 1946, and from expenditures on behalf of the United States and its armed forces in China for the same period.

The agreement is intended to be an overall settlement of surplus sales to China and encompasses within itself all previous surplus agreements and commitments with the exception of the West China surplus over and above that represented by the down payment (see item (d) below). These commitments were agreed to total 74 million dollars. They included:

(a) The Calcutta stockpile of trucks valued at approximately 25 million dollars.

This equipment was originally military lend-lease for China which was left stranded in India at the end of the war. It was declared surplus and sold to China early in 1946. This so-called "Calcutta deal" was originally valued at 40 million dollars and included additional surplus located at Chabua and Sukkur, also in India. Perhaps the difference of 15 million dollars is included in categories (c) and (e) below. The stockpile at Calcutta consisted entirely of trucks.

(b) The Hogan Project valued at approximately 6 million dollars.

Details of this project are not available.

(c) The small ship program totaling approximately 28 million dollars, of which about 16 million dollars remains to be delivered.

This program consisted primarily of small barges and freighters.

(d) The down payment of 5 million dollars on the United States Army's West China sale.

This sale, which was concluded by authority of General Wedemeyer, was not approved by the Foreign Liquidation Commissioner so must be regarded legally as an Army sale of "abandoned property" rather than an FLC sale of surplus. Agreement on terms was reached in November 1945. In addition to the down payment of 5 million dollars, it provided for the reduction by CN$5,160 million of the United States Yuan debt and the payment of US$20 million on 3(c) terms. China continues to be bound by the last of these obligations.

(e) Miscellaneous small sales approximating 10 million dollars.

At least a part of these sales are believed to include surplus which was originally in the "Calcutta deal" referred to in item (a).

In addition to the above previously committed surplus, China agreed to buy hitherto unsold movable surplus located in China and in the Western Pacific outside of the Philippines valued at 500 million dollars original cost, plus fixed installations in China valued at 85 million dollars original cost. Much of this equipment is widely scattered over various islands of the Pacific. Some is in good condition and the rest is in various states of disrepair and deterioration. Since the United States made no commitment to make an itemized inventory, the agreement provided that if there should be a material disparity between the property sold to China and the consideration given therefor, the Chinese and American Governments would consult together to fix an appropriate adjustment of the prices.

In order that the problem of moving and rehabilitating the property might not prove too great a strain on China's resources, the United States agreed to make a cash payment of 30 million dollars as part settlement of the yuan indebtedness. Of this sum 25 million dollars is to pay for transport of the surplus goods on United States vessels and for any other dollar obligations arising from the transaction. The remaining 5 million dollars is to be used to hire an American engineering firm to be employed by China to coordinate the operations of packing, rehabilitating and shipping the property to China, and to purchase materials and parts needed for these purposes. China is given 22 months within which to remove the property from the Pacific Islands.

China on her part agreed to cancel the American yuan indebtedness (estimated by the Americans at about the equivalent of 150 million dollars and probably by the Chinese at almost twice that amount) and in addition to make available in CN dollars the equivalent of US$55 million. Of this total 20 million dollars is to be used for promoting research, cultural and educational exchange with the United States and 35 million dollars for the acquisition of Embassy and Consulate building sites and for financing United States Government expenditures in Chinese currency. The yuan settlement was the third such settlement since the beginning of the war. In February 1945, there was a settlement of 210 million dollars to cover the period through September 1944. In May 1945, 45 million dollars was paid to cover the last quarter of 1944.

The agreement is not an overall financial settlement with China. One of its articles states that it was made "without prejudice to the final settlement of accounts between the United States and China arising out of the war." China undertakes to begin negotiations for such settlement at Washington as soon as possible. The principal items on which agreement has yet to be reached are military and civilian lend-lease (excepting lend-lease pipe-line goods which have already been sold on 3(c) terms for 58.9 million dollars) and the 500 million dollar loan of March 1942.

The following summary of the agreement has been worked out:

| | Orig. cost | | US$ Equivalent (In millions) |
|---|---|---|---|
| Chinese payments to U.S. (all in local currency): | | | |
| Past: | | | |
| Yuan advances Jan. 1, 1945 - Aug. 31, 1946 | | | 150 1/ |
| Future: | | | |
| For research, cultural and educational activities | | | 20 |
| For acquisition of U.S. property in China and for financing U.S. Government expenditures in Chinese dollars | | | 35 |
| Total | | | 205 |
| Chinese receipts from U.S.: | | | |
| Cash (U.S. dollars; to be offset against the yuan advances) | | | 30 |
| Surplus: | | | |
| Surplus previously committed: | | | 74 |
| Surplus represented by West China down payment | n.a. | 5 | |
| Calcutta stockpile | n.a. | 25 | |
| Hogan project | n.a. | 6 | |
| Miscellaneous surplus | n.a. | 10 | |
| Small ship program(already delivered) | n.a. | 12 | |
| Small ship program(to be delivered) | n.a. | 16 | |
| Surplus newly committed: | | | 101 1/ |
| Movables in China and Western Pacific | 500 | 95 1/ | |
| Fixed installations in China | 85 | 6 | |
| Total | about 800 | 175 | 205 |

n.a. - Not available.

1/ A residual figure based on information in the FLC press release of September 3.

Admittedly, many of the value figures in the above table are no better than well-informed estimates. Taking them at their face value, however, the United States received approximately 175 million dollars (after subtracting 30 million dollars paid in cash against the yuan advances) for surplus property the total of which originally cost about 800 million dollars. Thus the United States recovered approximately 22 per cent of the original cost, a percentage which compares favorably with other bulk surplus transactions. This percentage would be raised or lowered as one raised the value of the United States dollar equivalent of the yuan advances (as the Chinese would be likely to do) or raised the value of the fixed and movable surplus in China and the Western Pacific.

It is quite clear that the sale was advantageous to the United States, particularly to the Army and the Foreign Liquidation Commission, in that it disposed of all United States surplus in the Western Pacific and in China at one stroke, and apparently at a reasonable price. Much of the property has already deteriorated considerably because of time and weather and has required constant care and guarding by American troops. Those elements in Congress and the American public who desire to reduce our overseas commitments will be particularly happy to have this surplus out of the way. China, on the other hand, acquired approximately 1-1/2 million tons of equipment which, while of doubtful value in a highly organized and integrated economy like the United States, may be of great value in the rehabilitation of China.

On the debit side, the American Government will have to face the criticism of those who charge that we are aiding the National Government in the civil war. It may be argued, however, that the surplus is all non-military and that in any case it will not become available for many months. Although the agreement is satisfactory from the standpoint of disposing of surplus property, the United States has probably sacrificed much of its bargaining power with respect to a lond-lease settlement. If any charge at all is made for lend-lease, settlement will probably have to be on 3(c) credit terms rather than more logically as an offset against the yuan advances. This would have the unfortunate result of creating a long-term debt to the United States for military assistance during and after the war, whereas such a debt might more appropriately have been associated with surplus property which could be used for post-war rehabilitation. The settlement of post-VJ Day lend-lease may prove to be especially difficult. This aid was extended to China ostensibly to assist in disarming and repatriating Japanese troops, but also with the practical result of enabling the Government to reoccupy territory which might otherwise have fallen to the Communists. Should the United States wish to charge China for some or all of it, an offset solution might have been simpler, more logical, and more easily reached than a long-term credit solution.

Recent Exchange Regulations in Brazil

Harold Wexler

On July 22, 1946, the Banco do Brasil announced that the official market rate for foreign exchange had been abolished and that henceforth only the free market rate existed. The exchange rates before the abolition of the official market rate were:

Rates of Exchange as of June 24, 1946
(Cruzeiros per dollar)

| | Selling | Buying |
|---|---|---|
| Official | 16.50 | 16.50 |
| Free (before charges) | 19.50 | 19.18 |
| Free (after charges) | 20.10 | 19.30 |

After July 22, 1946, the only rates quoted by the Banco do Brasil were the following:

| Selling | Buying |
|---|---|
| 19.53 | 18.74 |

Exporters were formerly required to deliver 20 per cent of the exchange proceeds of their exports to the Banco do Brasil at the official exchange rate. The remaining 80 per cent of the exchange proceeds of exports, together with all other exchange entering the country, was considered free market exchange, and as such could be sold to banks or other authorized dealers at the free market buying rate. Exporters thus received an average of 18.74 cruzeiros per dollar, an average equal to the buying rate established July 22.

The free market rates after July 22 maintained approximately the same spread between buying and selling rates as formerly and included the 3 per cent tax on exchange sales.

The Director of Exchange of the Banco do Brasil gave three reasons for the change in official policy:

(1) Elimination of the multiple rates is in accord with the agreement entered into by Brazil in connection with the establishment of the International Monetary Fund and the International Bank.

(2) The new rate serves, although only to a limited extent, to combat increased prices in the United States, at present the principal source of supply for Brazil.

(3) There had been rumors to the effect that the cruzeiro was to be devalued, notwithstanding statements to the contrary by Government officials. It was felt that this step would be more effective in silencing those rumors than any number of denials from official sources.

The rates in the market now vary on a day-to-day basis according to supply and demand, but the Banco do Brasil, transacting more exchange business than all other banks combined, is in a position to influence quotations greatly. As of July 24, commercial banks were operating in the exchange market at rates different from those fixed by the Banco do Brasil. The rates as of this date were as follows:

| | Selling rate | Buying rate | Spread |
|---|---|---|---|
| Banco do Brasil | 19.53 | 18.74 | .79 |
| All other commercial banks | 19.45 | 18.62 | .83 |

The differential is probably explained by an increase in the supply of exchange to banks other than the Banco do Brasil. Since the Banco do Brasil kept its buying rate at 18.74 while the commercial banks were buying at 18.62, there was a switch of foreign exchange sales to the Banco do Brasil. The Banco do Brasil had plentiful exchange but buyers were able to purchase foreign exchange through the commercial banks at a more advantageous rate.

On July 26, 1946, Decree law No. 9522 eliminated the 3 per cent tax on exchange sales established by article 14 of Decree law No. 9025 of February 27, 1946. As a result, the selling rate of the Banco do Brasil was changed from 19.53 to 18.96. On August 19, the selling rate again changed to 18.72 and the buying rate to 18.50. Recent fluctuations in exchange rates are shown in the following table:

| | Banco do Brasil | | | Commercial Banks | |
|---|---|---|---|---|---|
| | Selling | Buying | Spread | Selling | Buying |
| Before July 22 | 20.10 | 19.30 | .80 | n.a. | |
| July 22 | 19.53 | 18.74 | .79 | 19.45 | 18.62 |
| July 30 | 18.96 | 18.74 | .22 | n.a. | |
| August 19 | 18.72 | 18.50 | .22 | n.a. | |

The net result of the changes which have taken place since the abolition of the official market is a 6.9 per cent appreciation of the cruzeiro as compared with the former 20.10 selling rate, and about a 4 per cent appreciation in terms of the former buying rate of 19.30. A decrease in the spread between buying and selling rates from 80 centavos to 22 centavos has been effected, largely as a result of removal of the tax.

Consequences of the New Developments. The July 22 buying rate of 18.74 gave exporters the same number of cruzeiros for their dollars, since the former average was 18.74. The change in the buying rate as of August 19 to 18.50 gives the exporters 1.3 per cent fewer cruzeiros per dollar. The amount of coffee offered for export is not likely to be affected by the latest exchange quotation since the loss of 24 centavos per dollar on exchange sales by exporters is more than compensated for by the recent OPA price increase of 8.32 cents (U.S.) per pound paid to the Brazilian exporter. The movement of the Brazilian buying rate from 18.74 to 18.50 is believed to have resulted from the current situation in the exchange market and not from a deliberate move on the part of the Brazilian Government. In an agreement with the United States, the Brazilian Government has pledged itself not to manipulate its exchange rates so as to affect adversely offerings of Brazilian goods for the United States market.

New capital coming into Brazil will be unfavorably affected in that each dollar will secure only 18.50 cruzeiros instead of 18.74 or 19.30 as before. Tourists going to Brazil will receive fewer cruzeiros for their dollars.

The new selling rates for dollars allow the Brazilian importer to buy dollars about 6.9 per cent more cheaply than before and will tend to encourage imports. The recent changes will also raise somewhat the realized earnings of foreign concerns in Brazil because interest and dividends may be transferred more advantageously.

Brazilians hope that the changes which have been effected in exchange rates will help to combat inflation, but it is doubted if they will be of material aid since they are not of significant proportions.

## Devaluation of the Turkish Lira

Ali R. Bengur

On September 7, 1946, the Turkish Government announced its decision to raise the official dollar buying rate, effective September 9, from approximately LT 1.29 (77.51 United States cents per pound) to LT 2.80 (35.71 United States cents per pound), and to abolish premiums on all foreign exchange transactions. The rates for other currencies were readjusted at the same time on the basis of the new dollar rate. Comparison of the old and new official rates shows a fall in the value of the lira (as the Turkish pound is called domestically) of about 53 per cent. Such a comparison, however, is misleading. At the time of the change, the official rate was not the representative rate in Turkey and its use was restricted to certain types of government transactions. By far the greater proportion of transactions in foreign exchange was carried out at what may properly be called the premium rate. This rate was derived by adding to the official buying and selling rates amounts equal to 40 and 48 per cent of those rates respectively. The middle premium rate was approximately 53.27 United States cents per lira when the new rate was announced. A comparison of the premium rate with the new official rate shows that the decline in the lira's value was in fact no more than 33 per cent.

The recent devaluation was not an unexpected development. It was a known fact both inside and outside the government that the lira, even at the premium rate, was considerably overvalued in terms of the United States dollar and other so-called hard currencies, and that some adjustment would have to be made either through devaluation or internal deflation if Turkey were to maintain a competitive position for its products in world markets. Deflation, although much desired by people with fixed incomes, was not generally considered to be a feasible solution. It was believed that under the present state of government finances it would be slow, costly, and painful. The budget was not in balance, and the practice of financing the budget deficit by means of advances from the Central Bank had not been altogether abandoned. Improvement in this situation depended primarily upon elimination or substantial reduction of the extraordinary defense expenditures required for the maintenance of a large mobilized army. No one could foresee when Turkey's international position might be so stable as to permit a general demobilization, thereby relieving the strain on government finances. It is apparent that under such conditions deflation could not be undertaken immediately, and that even if it were initiated, it would take a long time to bring about the necessary decline in the domestic price level. Such a course would not be in keeping with existing conditions of world trade. Turkey was under pressure to effect an immediate adjustment between its prices and world prices. Other countries producing competitive products had partially recovered from the ravages of war, and were gradually beginning to regain their former trading positions in the world. The loss of the greater part of the Central European market made it all the more necessary and urgent for Turkey to consolidate and expand its hold in the remaining world markets. The reasons for a speedy readjustment of Turkey's international economic position were therefore compelling, and the course lay in devaluation.

The timing of the devaluation and the extent to which the value of the lira should be lowered were major subsidiary problems. The most important single factor influencing the government to devalue at this time may have been its anticipation of membership in the International Monetary Fund. Turkey applied to the Fund for membership about six months ago and expects its application to come up for consideration at the meeting of the Fund's governors scheduled for the end of September. That this was an important factor is confirmed by the phraseology of the government's devaluation announcement, which emphasizes the country's adherence in its general foreign trade policy to the principles promulgated in the Bretton Woods Agreements. The approach of the Turkish export season may have been another consideration in the timing of devaluation. It is reported that Turkey has a bumper crop this year, and by making the terms more attractive to foreign purchasers, it is hoped that the entire exportable surplus may be disposed of. In fact, the government expects a rise in foreign exchange returns as a result of higher exports made possible by the new rate.

There is no information as yet, official or otherwise, upon which one may base a considered judgment as to the reasonableness of the new dollar rate. It is difficult, with information available here, to answer satisfactorily the question whether the lira is still overvalued at the new rate and, if so, by how much. The new rate, for example, compares closely with the Istanbul black market rate for telegraphic transfers on New York, which was about 37 United States cents per lira in June 1946, and is reported to have remained steady since the beginning of the year. But such a comparison could not in itself lead to any significant conclusion. Other factors such as the volume of transactions made at the black market rate, and the risk premium involved in black market dealings would have to be known in order to determine how representative the black market rate was or how useful it might be as a basis for comparison with the newly established rate.

Comparisons based on purchasing power rates computed from available data are no more satisfactory. In addition to the difficulties connected with selection of the proper index for this purpose, there is the equally difficult task of determining the parity rate between the lira and the dollar in the base year. If 1938, for example, were the selected base year, it would be observed from a study of premiums paid by Turkish importers on certain foreign currencies that the lira was overvalued in that year. The premiums on pound sterling and Swiss francs were as high as 45 per cent of the Turkish official selling rates for those currencies. But the use of premiums in the pre-war period was not general. It was restricted mainly to compensation transactions with certain countries. The United States dollar, for instance, was not on the list of currencies for which premium quotations were given in 1938, according to the bulletin of the Central Bank of Turkey. Notwithstanding lack of premium quotations on the United States dollar, it might still be assumed that the lira was overvalued in terms of the dollar in 1938; but there are no figures to indicate the degree of overvaluation. Because of this inability to arrive at an acceptable parity rate between the lira and the United States dollar in the base year, and the unsatisfactory state of the retail price index in Turkey, it has not been possible to produce a representative purchasing power rate with which the new dollar rate might be advantageously compared.

However, several computations of purchasing power rate have been made. A computation based on comparison of retail price indexes of the United States and Turkey at the official parity rate in 1938 has yielded the most conservative result and indicates an overvaluation of only one per cent for the new dollar rate in terms of the computed rate. This is largely because the Turkish retail price index used measures price changes in only one city, namely Ankara, and has been computed on the basis of controlled prices (including rents) which would not be representative for the rest of the country. The wholesale price index, on the other hand, is more representative of price changes in the country at large, and should therefore be preferred to the retail price index for the purpose of purchasing power rate computations. Two separate computations were made on the basis of wholesale price index comparisons. In one case the lira and the dollar were assumed to be at parity in 1938 at the official rate, and in the other at a rate computed on the basis of the premium paid on pound sterling, namely 45 per cent of the official selling rate. The latter computation naturally indicated the highest degree of overvaluation for the new dollar rate in terms of any of the computed rates. But the result of the former computation, indicating a current overvaluation to the extent of one-third of the computed rate, is no less noteworthy.

In spite of the divergencies among computed rates, depending upon the price indexes used and assumptions made with respect to parity in the base year, all the computations support the conclusion that the lira is still overvalued at the new rate. It is probable that the Turkish Government has taken this step intentionally, counting on anticipated price decreases in Turkey and probable price increases in the United States to eliminate any existing deferential.

Price Parity Exchange Rates

Florence Jaffy

The tables given below extend and bring up to date, with some changes, the material compiled last May under the title "Purchasing Power Parity Calculations for Selected Countries."

The basis for the calculations, as previously stated, is the assumption that price levels and exchange rates were in equilibrium in some base period. Price indexes are computed relating current prices in each country to those of the same base period. The exchange rate which prevailed for each country during the base period is then multiplied by the current ratio of the United States price index to that country's price index. The resulting price parity rate cannot be taken literally as the "true value" of the given currency, for reasons explained in the previous memorandum, but it is of interest as an indicator of an important factor affecting the "true" currency value.

The 1928 base period used in the former calculation is dropped from the present paper; calculations here are made on a base of October 1936 to June 1937. This more recent base period allows less opportunity for changes in other economic forces which affect the value of a currency.

Seven countries, which, unlike the rest, are not members of the International Monetary Fund, have been added to the list. They are Argentina, Australia, New Zealand, Spain, Sweden, Switzerland, and Turkey.

It will be noted that, of the two countries which have recently appreciated their currencies, Canada appears justified,1/ since its price parity values of 97.99 and 105.30 are closer to the new value of the Canadian dollar than they are to the old. The Swedish krona, however, on the basis of our calculations, appeared overvalued even before the appreciation. Turkey, which recently devalued its currency, appears clearly justified, the new value of the Turkish lira being much closer than the old to the two price parity rates, though not so low as either. The Swiss currency, much talked of in regard to appreciation, is already overvalued according to our figures.

The only clear cases of undervaluation with respect to price parity are Australia and Uruguay, though the Union of South Africa and the United Kingdom would also appear undervalued if only the cost of living parity were taken into account. Subsidies undoubtedly explain the low cost of living figures responsible for this result in the case of the United Kingdom.

Where comparisons can be made between the parity calculations of the earlier paper (most of which were carried to around January 1946) and those of the present paper (carried to around May 1946), it appears that the price parities have in most cases gone

1/ In the sense of an approach to price parity. Nowhere do we mean to imply that price parity rates are necessarily true equilibrium rates.

down in this four-month interval--i.e., price advances in most foreign countries during this period were greater than in the United States. However, since no foreign price figures were available for months later than June, United States price index numbers used for comparisons were also no later than June, and consequently the present calculations do not take account of price developments in the United States since that month.

Countries whose price parities have risen since the last calculation include Costa Rica, Denmark, the Netherlands, Norway, the United Kingdom, and South Africa (the latter on a wholesale price basis).

The parities for Cuba and Egypt are not strictly comparable with those calculated earlier, due to variations in procedure.

Table I
Price Parity Exchange Rates Compared with
Actual Rates for Selected Countries[1]
(In cents per unit of foreign currency)

| Country | Parity Rates: Wholesale Price Parity | | Parity Rates: Cost of Living Parity | | Actual Rates: In August 1946[a] | | Actual Rates: In Base Period October 1936 - June 1937[a] |
|---|---|---|---|---|---|---|---|
| Argentina | 5/46 | 20.33 | 1/46 | 30.42 | | 29.77 | 32.72 |
| Australia | 2/46 | 344.71 | 10-12/45 | 382.99 | | 321.41 | 391.08 |
| Belgium | 1/46 | 1.64 | | - | | 2.28 | 3.37 |
| Brazil | | - | 6/46 | 3.65 | | 5.37 | 6.13 |
| Canada | 5/46 | 97.99 | 5/46 | 105.30 | | 100.00 | 100.04 |
| Chile | 4/46 | 3.02 | 4/46 | 2.44 | 6/46 | 3.23 | 5.17 |
| Costa Rica | 6/46 | 11.43 | 6/46 | 11.50 | 3/46 | 17.79 | 16.26[b] |
| Cuba | | - | 6/46 | 68.38 | | 100.00 | 99.92[c] |
| Czechoslovakia | 5/46 | 1.57 | 6/46 | 1.35 | | 2.01 | 3.51 |
| Denmark | 6/46 | 16.10 | 3/46 | 17.47 | | 20.88 | 21.91 |
| Egypt | 12/45 | 208.26 | 12/45 | 229.70 | | 413.70 | 503.23 |
| France | 6/46 | 0.83 | 6/46 | 0.66 | | 0.84 | 4.59[d] |
| Greece | | - | 6/46 | 0.01 | 5/46 | 0.02 | .90 |
| India | 4/46 | 15.37 | 4/46 | 20.06 | | 30.18 | 37.07 |
| Iran | 12/45 | 1.12 | | - | | 3.076 | 6.07 |
| Mexico | 6/46 | 13.86 | 5/46 | 11.42 | | 20.59 | 27.75 |
| Netherlands | 4/46 | 29.73 | 3/46 | 40.00 | | 37.79 | 54.55 |
| New Zealand | 4/46 | 309.20 | | - | | 322.70 | 394.01 |
| Norway | 6/46 | 18.66 | 6/46 | 19.32 | | 20.16 | 24.66 |
| Peru | 5/46 | 13.65 | 5/46 | 16.16 | 8/46 | 15.38 | 25.07[e] |
| Poland | | - | 12/45 | 0.26 | | 1.00 | 18.90 |
| Spain | 12/45 | 2.86 | | - | | [f]9.13 | 6.86 |
| Sweden | 5/46 | 20.13 | 6/46 | 22.02 | 5-6/46 | 23.85<br>27.82 | 25.30 |
| Switzerland | 6/46 | 15.46 | 6/46 | 19.58 | | 23.36 | 22.90 |
| Turkey | 5/46 | 25.52 | 5/46 | 31.57 | | 55.55 | 80.11[g] |
| | | | | | 9/46 | 35.71 | |
| Union of So. Africa | 3/46 | 391.01 | 3/46 | 443.02 | | 400.50 | 485.70 |
| United Kingdom | 6/46 | 386.45 | 6/46 | 479.16 | | 403.36 | 490.81 |
| Uruguay | | - | 4/46 | 67.85 | | 56.27 | 79.47[e] |

1/ Sources of price indexes are given in Table II in the Appendix. Exchange rates from the Federal Reserve Bulletin and from Foreign Commerce Weekly.

a/ Unless otherwise indicated.

b/ Average rate for 1936; used as base for Costa Rican calculation.

c/ Average rate for July 1937 to December 1937; used as base for Cuban calculation.

d/ Used only for wholesale parity. Cost-of-living parity was based upon an average rate of 2.88 for 1938.

e/ Average for 1936 and 1937; used as base for both Peru and Uruguay.

f/ Beginning August 25, 1946, a preferential rate of 6.09 cents/peseta for tourist expenditures and family remittances supplements the above.

g/ Average rate for 1938; used as base for Turkish calculation.

Table II
Price Indexes Used in Price Parity Calculations*
(Base Period October 1936 to June 1937 unless otherwise indicated)

| Country | Wholesale Price Index | | Cost of Living Index | |
|---|---|---|---|---|
| | Date for which computed | Value of Index | Date for which computed | Value of Index |
| Argentina | May 1946 | 208.1 | January 1946 | 138.1 |
| Australia | February 1946 | 141.7 | Oct.-Dec. 1945 | 130.6 |
| Belgium | January 1946 | 256.8 | | - |
| Brazil | | - | June 1946 | 221.0 |
| Canada | May 1946 | 132.0 | May 1946 | 123.6 |
| Chile | April 1946 | 218.6 | April 1946 | 274.5 |
| Costa Rica | June 1946 | 197.9 a/ | June 1946 | 190.1 a/ |
| Cuba | | - | June 1946 | 201.2 b/ |
| Czechoslovakia | May 1946 | 288.8 | June 1946 | 343.1 |
| Denmark | June 1946 | 178.4 | March 1946 | 161.4 |
| Egypt | December 1945 | 301.8 | December 1945 | 281.3 |
| France | June 1946 | 724.8 | June 1946 | 577.0 c/ |
| Greece | | - | June 1946 | 10,760.4 |
| India | April 1946 | 307.8 | April 1946 | 239.0 |
| Iran | December 1945 | 674.4 | | - |
| Mexico | June 1946 | 262.5 | May 1946 | 316.2 |
| Netherlands | April 1946 | 234.1 | March 1946 | 175.5 |
| New Zealand | April 1946 | 162.6 | | - |
| Norway | June 1946 | 173.3 | June 1946 | 168.1 |
| Peru | May 1946 | 237.5 | May 1946 | 201.8 |
| Poland | | - | December 1945 | 9,272.0 |
| Spain | December 1945 | 300.00 | | - |
| Sweden | May 1946 | 162.5 | June 1946 | 151.3 |
| Switzerland | June 1946 | 194.2 | June 1946 | 154.0 |
| Turkey | May 1946 | 442.3 c/ | May 1946 | 331.7 c/ |
| Union of So.Africa | March 1946 | 158.5 | March 1946 | 141.1 |
| United Kingdom | June 1946 | 166.5 | June 1946 | 134.9 |
| United States | December 1945 | 124.9 | December 1945 | 128.4 |
| | January 1946 | 124.9 | January 1946 | 128.4 |
| | February 1946 | 124.9 | February 1946 | 127.9 |
| | March 1946 | 127.6 | March 1946 | 128.7 |
| | April 1946 | 127.6 | April 1946 | 129.3 |
| | May 1946 | 129.3 | May 1946 | 130.1 |
| | June 1946 | 131.1 | June 1946 | 131.7 |
| Uruguay | | - | April 1946 | 150.5 d/ |

* Sources: League of Nations Statistical Yearbooks and Monthly Bulletins, government publications of France, Cuba, Poland, Consular reports. For U.S., Bureau of Labor Statistics index, as given in Federal Reserve Bulletin and League of Nations monthly bulletins.

a/ 1936 base period. b/ July-December 1937 base period. Food prices only.
c/ 1938 base period. d/ 1936-37 base period.

Cost of living figures for recent months for Poland, Greece, and the Netherlands, and a recent wholesale price figure for Belgium were obtained from consular reports or government publications, and converted to the 1936-37 base period by the use of earlier indexes as given by the League of Nations. Spanish and New Zealand figures for 1936 and 1937 were adjusted so as to be comparable with the recent figure used. In all other cases, continuous series were available.